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In the

Supreme Court of the United States

OCTOBER TERM, 1968

ELMER E. MILLS AND LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTOLITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners pray that a writ of certiorari issue to the United States Court of Appeals for the Seventh Circuit to review the judgment of that Court entered on November 25, 1968, which reversed an order of the District Court for the Northern District of Illinois granting plaintiffs' motion for partial summary judgment.

OPINIONS BELOW

The opinion of the Court of Appeals for the Seventh Circuit, 403 F.2d 429, and its order are set forth in the Appendix, *infra* page 1a, and the opinion of the District Court for the Northern District of Illinois, 281 F.Supp. 826, appears at page 14a, *infra*. The District Court's Findings of Fact appearing without substantial controversy, the Conclusions of Law on which summary judgment was granted, and its earlier unreported opinion set forth beginning at page 22a of the Appendix.

JURISDICTION

The order of the Court of Appeals for the Seventh Circuit sought to be reviewed was entered on November 25, 1968. On February 21, 1969, Mr. Justice Marshall entered an order extending time to file petition for writ of certiorari until March 10, 1969. This Court has jurisdiction under 62 Stat. 928, 28 U.S.C. 1254(1). The case arises under the provisions of the Securities Exchange Act of 1934, as amended, 48 Stat. 881, 15 U.S.C. § 78a *et seq.*

QUESTIONS PRESENTED

1. Whether minority stockholders are denied any federal remedy for material misrepresentations in a proxy statement, violative of Section 14(a) of the 1934 Act, soliciting necessary votes for a merger, if the court can be satisfied that the merger terms are fair by common law standards.

2. Whether liability for material misrepresentation in a merger proxy statement violating Section 14(a) of the 1934 Act depends upon a factual finding that a critical number of votes were changed by the particular omission or misrepresentation.

3. Whether a factual finding, if relevant, that a critical number of votes were not changed by the particular omission or misrepresentation in a merger proxy statement, excusing its violation of Section 14(a) of the 1934 Act, may be predicated upon fairness of the financial terms of merger.

4. Whether all relief for material misrepresentation in a proxy statement for a merger enjoinable under Section 14(a) of the 1934 Act is barred by consummation of the merger if the court can be satisfied that the merger terms are fair by common law standards.

THE STATUTES AND RULES INVOLVED

Section 14(a) of the Securities Exchange Act of 1934 (the "1934 Act"), as amended, 15 U.S.C. § 78n(a) provides:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect to any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 14a-9(a) promulgated by the Securities and Exchange Commission pursuant to Section 14(a) of the 1934 Act, 17 C F R § 240.14a-9(a) provides:

> No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and

> in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

Section 29(b) of the 1934 Act provides "every contract made in violation of any provision of this chapter or any rule or regulation thereunder * * * shall be void * * * as regards the rights of any person who, in violation of any such provision, rule or regulation, shall have made or engaged in the performance of any such contract."

STATEMENT OF THE CASE

Plaintiffs were shareholders of The Electric Autolite Company ("Autolite"), until its merger in 1963 into Mergenthaler Linotype Company ("Mergenthaler"), which was thereupon renamed Eltra Corporation. Suing for the shareholders of Autolite as a class and derivatively on behalf of Autolite, plaintiffs alleged that the proxy statement used by the management of Autolite to solicit votes in favor of the Autolite-Mergenthaler merger was materially misleading[1] in violation of Section 14(a) of the 1934 Act and Rule 14a-9 thereunder.

Plaintiffs alleged that because votes essential to authorization of the merger were obtained through use of the unlawful proxy statement, the merger was void, and

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[1] The principal statement alleged and found to have been misleading was the advice and opinion of the Board of Directors of Autolite recommending the merger, without disclosing that the entire Board consisted of persons controlled by Mergenthaler, the adversary in the merger. App. 8a-9a.

prayed that the merger be set aside, that the assets of Autolite be returned to it, and that damages and other appropriate equitable relief be awarded. Rec. 179-180.

The District Court and the Court of Appeals both held that "mailing the proxy statement was unlawful under" Section 14(a) of the Act, because of its "omission of a material fact necessary in order to make the statements therein not misleading." App. 9a. The District Court and the Court of Appeals both found, additionally, that without the votes of the minority stockholders, obtained through the unlawful proxy solicitation, approval of the merger was not obtained. App. 10a.[2]

Having made these findings, the District Court entered "summary judgment . . . on the issue of liability alone" (Rule 56(c), Fed.R.Civ.Pro.), in the nature of a declaratory judgment for petitioners. App. 27a-28a. "Relief was left for further consideration after hearings before a special master and a report thereon." App. 10a.

The Court of Appeals held that, although the proxy statement was materially misleading, the facts did not suffice to establish the requisite causal relationship between the proxy statement and the merger, because in its view "the more exact question is whether the misleading statement and omission caused the submission of sufficient proxies." App. 11a.

This formulation of the question was thought to follow from the court's premise that liability is not established unless "the unlawful act caused some inequity or damage

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[2] "* * * the merger required favorable votes representing at least two-thirds of the Autolite shares, and * * * in order to count a two-thirds vote, one must include votes which were cast by authority of proxies obtained by the challenged solicitation". App. 10a.

which the court should relieve or redress." App. 10a. The opinion assumed that there would be nothing to relieve or redress if the trial judge were satisfied of the probability that "the merger would have received a sufficient vote even if the proxy statement had not been misleading." App. 11a. The court acknowledged that this approach smacks of the common law fraud test, "whether the injured party relied on the misrepresentation" App. 11a, n. 10. It eschewed direct resolution of that question, however, on the ground that "[r]eliance by thousands of individuals, as here, can scarcely be inquired into." *Ibid.* It resorted, instead, to indirect resolution, predicated upon a presumption that stockholders would have voted for merger, regardless of misrepresentation, if "the merger has merit and the terms were in fact fair and equitable to the minority shareholders." App. 11a. With the aid of this presumption, the court below was able to conclude: "The material offered by defendants on the merits of the terms of merger suggests that it may be possible for them to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." App. 11a.

On this approach, if defendants could satisfy the court of the merit and fairness of the substantive terms, "there would be no sound basis for disruption of the merger *or other relief*", regardless of the material violation. App. 11a. (emphasis added). The Court of Appeals' express rationale was its unwillingness to "unscramble a corporate transaction merely because a violation occurred." App. 12a.

The court rejected petitioners' claim that legal injury consists of the invasion, through material misrepresentation, of the right of Autolite to continue its corporate existence, and of its shareholders as a class to preserve that status, until altered through authorization obtained in accordance with law, and that merit or fairness of the substantive terms is therefore irrelevant to the issue of liability. App 10a.

Accordingly, the court reversed and remanded the cause for further proceedings on the issue of liability (App. 12a), assessing all costs of the appeal against petitioners. App. 13a.

REASONS FOR GRANTING THE WRIT

The ruling below bars any remedy for an adjudged violation of federal law and is in conflict with decisions of this Court, and of the other federal courts, declaring that the congressional purpose must be made effective by providing a remedy when violation occurs. The principle announced by the lower court would apply, if unreversed, to a broad range of cases arising under the securities laws and under other federal regulatory statutes requiring full disclosure and fair voting. It narrows the broad remedial federal policy to the restrictive limits of the common law, making federal law superfluous. It would create almost insuperable obstacles to effective relief, and to private enforcement of federal commands on which Congress relied for effective law enforcement. Importance is measured not merely by the distortion of congressional policy, but by impairment of shareholder and public interests which the Securities Exchange Act was enacted to protect.

1. The decision below denies liability or remedy for a proven material violation of the Act, in conflict with this Court's decisions in Borak and National Securities.

This Court stated in *J. I. Case* v. *Borak,* 377 U. S. 426 (1964), "The purpose of 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation." 377 U.S. at 431. To achieve this purpose, the unanimous opinion declared that "it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." 377 U.S. at 433. To reinforce this duty, this Court held "§27 of the Act authorizes a federal cause of action for *rescission* or *damages* to a corporate stockholder with

respect to a consummated merger which was authorized pursuant to the use of a proxy statement alleged to contain false and misleading statements violative of §14(a) of the Act." 377 U.S. at 428 (emphasis added).

These component elements, under *Borak,* complete a federal "claim upon which relief can be granted" under Rule 12(b)(6), Fed.R.Civ.Pro., without regard to the form of appropriate relief. Finding these elements established here, the District Court properly adjudged the issue of liability, and ordered further hearings on the relief to be awarded. Contravening *Borak's* enumeration of the components of the statutory cause of action, the Court of Appeals imported two additional requirements from the action for common law fraud: reliance and unfairness.

This decision transforms the broad prophylactic prohibition of the Act against seeking stockholder authorization through misrepresentation into a narrow—and superfluous —condemnation of unfair or fraudulent transactions promoted by misrepresentation. Under the ruling below, the violation of federal law becomes a matter of no consequence; whether relief may be granted turns solely upon the fairness of the merger in its substantive terms. In effect, the court below adopted the contention of petitioners Harry G. Barr, et al., in their Brief in *Borak,* p. 10, No. 402, Oct. Term 1963: "[A] deficient proxy statement followed by a beneficial merger gives rise to no cause of action, but a lawful proxy statement followed by a fraudulent merger is actionable. In short, the violation of §14(a) has no crucial bearing on the main thrust of the claim." That reading of federal law this Court rejected in *Borak,* since if it would "attach no responsibility to the use of misleading proxy statements, the whole

purpose of the section might be frustrated." 377 U.S. at 434-35.

Securities and Exchange Commission v. *National Securities, Inc.*, No. 41, this Term, decided January 27, 1969, after the Seventh Circuit's opinion, establishes that the court below misconceived the import of *J. I. Case* v. *Borak*, 377 U.S. 426. *National Securities* holds that in enforcing a requirement of the Securities Act that management "speak the truth" when soliciting authorization for a merger from shareholders, the "gravamen of the complaint [is] the misrepresentation, not the merger. The merger [becomes] relevant only insofar as it [is] necessary to attack it in order to undo the harm caused by the alleged deception." In short, the merits of the merger and its fairness are irrelevant to the violation; they bear at best upon the question of particular relief, *e.g.*, whether vindication of the federal policy can best be achieved by "a return to the *status quo ante*." Whether "unscrambling" is appropriate in any given case poses a quite different question, governed by entirely different considerations, than the question whether material misrepresentation is a remediable violation.

The *Borak* decision itself makes the point. There the contention that "the merger can be dissolved only if [the merger] was fraudulent or non-beneficial * * *" was put aside with other "issues upon which the proxy material would not bear" (377 U.S. at 431), and which related only to "appropriate relief," (377 U.S., at 435), not to the sufficiency of the cause of action.

2. The decision below frustrates the congressional policy of full disclosure by reverting to common law standards of liability.

By transforming the question of the "causal relationship of the proxy material and the merger" (*Borak*, 377 U.S. at 428) into a requirement of a "causal relationship between *the deficiency in* the proxy statement and the merger" (App. 10a, emphasis added), the court below demanded more than the nexus between the number of votes necessary for authorization and the misrepresentations "calculatedly infused into the matrix" (*Laurenzano* v. *Einbender*, 264 F. Supp. 356, 361 (E.D. N.Y. 1966)) of the proxy statement used to secure them, and reintroduced by indirection elements of common law fraud which Congress eliminated in the interest of protecting investors. "Congress intended a broad remedial construction of the Act which would encompass nondisclosure of material facts," not one which turns on fraud and deceit in their technical sense including "intent to injure and actual injury • • •." *S.E.C.* v. *Capital Gains Bureau*, 375 U.S. 180, 186, 195.

The "injury" to stockholders and to the public consists of the non-disclosure "itself, with its potential for abuse, which 'operates as a fraud or deceit' within the meaning of the Act when relevant information is suppressed." *Ibid.*, at 200. In enacting a prophylactic measure against "the darkness and ignorance of commercial secrecy [which] are the conditions upon which predatory practices best thrive" (*ibid.*), Congress did not limit its thrust to transactions which, on the merits, are unfair or unworthy; it encompassed all transactions infected by their promoters with the virus of non-disclosure. Full disclosure is required not to assure fairness, but because it is

"essential to maintain public confidence in the securities industry and to preserve the economic health of the country." *Ibid.*, at 201; *J. I. Case Co.* v. *Borak*, 377 U.S. 426, at 431-32. "Section 14(a), (c) exacts candor of disclosure, not fairness of substantive terms * * *." *Laurenzano* v. *Einbender*, 264 F. Supp. 356, 361 (E.D.N.Y. 1966).

Congress having perceived and declared the injury, it is not for the courts to reevaluate its findings (*Katzenbach* v. *McClung*, 379 U.S. 294, 303-305) or to narrow remedial coverage to injuries of a different, more traditional, type.

Moreover, in the *National Securities* case this Court declared that a scheme to mislead shareholders which resulted in their losing their status as shareholders of one company and becoming shareholders in another is, despite approval of the merger by the State, a violation of federal law. Refusal of the court below to recognize petitioners' legally protected interest in remaining shareholders of Autolite unless and until authorization for merger is lawfully obtained (App. 10a), is incompatible with this Court's approach.

3. The decision below stultifies the congressional purpose by disenfranchising the stockholders and substituting a judicial appraisal of the merger's merits for their actual and informed vote.

The Seventh Circuit's presumption that minority stockholders would authorize a merger, despite material misrepresentations, if its terms "were in fact fair and equitable to them" is unsupportable in fact; more significantly, it is utterly destructive of the remedial objective Congress intended to achieve.

Direct proof of the actual effect upon the voter of a misrepresentation[3] or omission[4] in a proxy statement is unobtainable.[5] Voters are themselves unaware of which factors may have influenced their choice. This has been demonstrated repeatedly in political,[6] labor,[7] and

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[3] "To require direct proof that the votes of a critical number of shares were changed by the Hayden, Stone Report [the proxy solicitation material], and more precisely by its misleading portions, would raise insuperable obstacles to relief and nullify the legislative purpose. The present state of understanding of human mental processes does not enable us to weigh with exactitude the components of decision or to determine scientifically that any particular element was controlling. The law does not ask more than human knowledge can supply." *Union Pacific Railroad Company* v. *Chicago and North Western Ry.*, 226 F.Supp. 400, 411 (N.D. Ill. 1964).

[4] In nondisclosure cases, the abstract and supposititious question of "reliance" on unknown information means that any such requirement could be little more than a formal requirement. 3 Loss, Securities Regulation 1766 (2d ed. 1961).

[5] Mr. Justice Cardozo, speaking of proof of reliance in *DeCicco* v. *Schweizer,* 221 N.Y. 431, 438, 117 N.E. 807, 810 (1917) said: "The springs of conduct are subtle and varied. One who meddles with them must not insist upon too nice a measure of proof that the spring which he released was effective to the exclusion of all others."

[6] Campbell, Converse, Miller & Stokes, *The American Voter* (1960) 523: "The explanations offered for an electoral result are astonishingly varied; they depend typically on the slenderest evidence, and disagreements are commonplace even among knowledgeable observers." And see, *Bell* v. *Southwell,* 376 F.2d 659, 662 (5th Cir. 1967) setting aside an election tainted by racial discrimination despite plaintiff's "inability to demonstrate that the outcome would have been different."

[7] Bok, *The Regulation of Campaign Tactics in Representation Elections Under the National Labor Relations Act,* 78 Harv. L. Rev. 38 (1964) at 40, footnote 8: "• • •

corporate elections.[8] The possibility that shareholders would not have authorized a transaction "if [they] had known the facts" (*Garment Workers* v. *Labor Board*, 366 U.S. 731, 737) can never be refuted; that possibility establishes "the unlawful genesis" of their authorization. *Ibid.*

Judge Dooling defined the statutory premises correctly in *Laurenzano* v. *Einbender*, 264 F. Supp. 356, 362 (E.D. N.Y. 1966):

> "If proxies are solicited, the stockholders have a statutory right to a truthful proxy statement. Misleading proxy material impeaches the validity of the meeting, its efficacy as a meeting. A majority stockholding cannot legitimate a meeting based on misleading information by reference to its possession of votes that would suffice to end debate. The misleading proxy material deprives the meeting, and the majority stockholder, of the expressions of view and the votes that would have ensued upon truthful disclosure; it is not legally possible to decide what legal consequences flow from the informational defects in

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[7] (Continued)
very cumbersome investigations would have to be made in a large number of cases. Moreover, the testimony received would often be unreliable * * * because voters may be largely unaware of the true reasons for their ultimate decision * * *." And at 42: "In recognition of this fact, judges and administrators have agreed that actual interference with an election need not be shown to establish a violation of the law; it is enough that the conduct in question tends to have these effects," citing *Republic Aviation Corp.* v. *NLRB*, 324 U.S. 793, 798-800 (1945). Cf. *Labor Board* v. *Donnelly Garment Co.*, 330 U.S. 219, 231.

[8] Aranow and Einhorn, *Proxy Contests For Corporate Control* 510, (2d ed. 1968).

> the meeting by asserting that the meeting would have ended in the same resolutions no matter what the views or votes of the minority. *That is not necessarily the fact and it cannot be the resolving principle of law.*" 264 F.Supp. at 362. (Emphasis added.)

Having correctly rejected direct inquiry into the voters' mental processes as the measure of legality, the court below instead resorts to indirect conjecture to determine that state of mind. The stockholder's right to cast an informed vote, declared and guarded by Congress, is thus circumvented; the court casts his vote, in effect, upon a retrospective prediction of how he would have voted if he had known the facts. This after-the-fact inquiry proceeds upon a conclusive presumption that no fair offer will be declined. The stockholder's right to decide for himself, upon full disclosure, whether the merger is fair, beneficial, and meritorious, is effectively finessed. If, in the interest of effective law enforcement, inquiry into actual effect is barred,[9] *a fortiori* does that interest bar a presumption — a conclusive presumption to boot — that illegal misrepresentation is inconsequential.

Applicable here is this Court's observation in *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 366, note 18, "a substantive inquiry after the fact cannot possibly succeed in accurately ascertaining retrospectively what the outcome would have been had [the material misrepresentations not been made]. The conditioning of relief for the [misrepresentation] breach on a finding that a concomitant substantive breach occurred might well, there-

[9] The court below ascribed to mere impracticality avoidance of questioning "thousands of individuals" about their response absent misrepresentation. But, as we have seen, inquiry is foreclosed for more fundamental reasons.

fore, result in an ultimate wrongful denial of recovery • • •."

Congress enacted the 1934 Act to protect "[f]air corporate suffrage" and the "free exercise of the voting rights of stockholders." *Borak,* 377 U.S. at 431. To that end, it defined, in Section 29(b), the consequences upon a corporate transaction of its promotion by material misrepresentation: the transaction is "void." That forecloses denial of relief on the theory that material misrepresentations are "harmless." In *Eastside Church of Christ* v. *National Plan, Inc.,* 391 F.2d 357, 362 (5 Cir., 1968), cert. denied, 393 U.S. 913, the Fifth Circuit rejected the contention that the right to relief against violation of the 1934 Act is conditioned upon establishment "that any harm which [plaintiffs] suffered was caused by" the violation: "it is sufficient to show merely that the prohibited transactions occurred and that [plaintiffs] were in the protected class." In conditioning relief upon proof that the authorizing votes were caused by the material misrepresentation, the decision below is in square conflict with the Fifth Circuit.

The mainspring of the error below lies in failure to appreciate that Congress' objective was to compel full and honest disclosure, not to promote corporate transactions which happen to have "merit" or be "fair" to minority stockholders. Once Congress' policy is clearly perceived, it follows that insiders "cannot accomplish by deception what they might have accomplished honestly and then be heard to say that the deception was not the cause." *Eagle* v. *Horvath,* 241 F. Supp. 341, 344 (S.D.N.Y. 1965).

Under the lower court's test, ignoring the disclosure requirement, transactions deemed by a court to be "meri-

torious" and "fair" to minority stockholders could be fraudulently promoted with impunity. The fraudulent promoter would get two bites of the apple. If his fraud is not discovered, he would enjoy the fruits of deception without hindrance. If discovered, he may yet escape liability by convincing a court that the transaction itself was meritorious and "fair and equitable to the minority shareholders." Thus, the Seventh Circuit's approach "would place a premium on concealment [of material facts] and thereby jeopardize the salutary policies of the statute." *Wolf* v. *Weinstein*, 372 U.S. 633, 654. Moreover, on that approach, the disclosure requirements of the federal securities laws add precisely nothing to the protection of shareholders; fraudulent and unfair transactions always have been actionable in state courts.

4. The decision below stifles private enforcement suits, a necessary supplement to Commission action in enforcing the Act, by raising insuperable obstacles to relief.

In *Borak* this Court observed (377 U.S. at 432):

> "Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in anti-trust treble damage litigation, the possibility of *civil damages* or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements." (Emphasis added).

This "necessary supplement" is virtually destroyed as an "effective weapon" by the holding below. As the Court of Appeals pointed out (App. 10a), petitioners own, between them, only 5/100 of 1% of the Autolite shares. They are the "little investors who need the greatest

possible protection."[10] Yet the court below would compel the smaller shareholder, even after he has established that the proxy solicitation was unlawful, to litigate the merits and fairness of the merger as a condition precedent to *any* relief. No small investor could afford to rebut the array of expert witnesses on fairness produced by the corporation, by himself engaging expert financial witnesses, causing exhaustive audits and investigations of the books and records of huge corporations, by the taking of lengthy depositions, and by financing such items as the court reporting of a protracted trial. If the time, expense and staff requirements of such an undertaking are not available to the SEC "to permit an independent examination of the facts set out in the proxy material" (*Borak*, 377 U.S. at 432-33), obviously the small investor, whose total stake may be less than such costs, is never in a position to undertake a full-dress trial to determine the fairness of a merger.

This Court recognized the danger of chilling private actions when it said in *Borak* (377 U.S. at 435):

> "• • • the hurdles that the victim might face (such as separate suits, as contemplated by *Dann* v. *Studebaker-Packard Corp., supra,* security for expense statutes, bringing in all parties for complete relief, etc.) might well prove insuperable to effective relief."

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[10] *Surowitz* v. *Hilton Hotels Corporation,* 383 U.S. 363, 371: [D]erivative suits have played a rather important role in protecting shareholders of corporations from the designing schemes and wiles of insiders who are willing to betray their company's interest in order to enrich themselves. And it is not easy to conceive of anyone more in need of protection against such schemes than little investors like Mrs. Surowitz." See also, *Tcherepnin* v. *Knight,* 389 U.S. 332.

The Court of Appeals in this case assessed against petitioners all costs of the appeal, approximately $9,000 (App. 13a-14a), on the theory that they had not yet established liability. Confronted with the prospect of such a cost bill, as a prelude to the cost of a trial on the merits and fairness of the merger, few, if any, investors could afford to undertake even the most meritorious Section 14(a) litigation.[11]

The court below implied that petitioners were at fault for not moving to enjoin the merger. App. 9a-10a. But that imputation overlooks the obstacles confronting the private litigant. Here the violation found by the courts below was not discovered until after the meeting to approve the merger had been held, when it was pleaded in an amendment to the complaint. Rec. 163, 169-71. Of necessity, delayed discovery will be common. See *J. I. Case Co.* v. *Borak*, 377 U.S. 426, at 432-33. Preliminary injunctions are also infeasible because of the requirement of obtaining an injunction bond at prohibitive cost, or of assuming the risk of damages in the event that permanent relief were ultimately denied. Enforcement through prospective suits, whether brought by the Commission[12] or by minority shareholders, falls far short of providing "such remedies

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[11] The effect of the decision below covers not only Section 14 but also Section 10(b) of the 1934 Act, which, as this Court held in *National Securities*, must be read in *pari materia*. The principles of the decision below apply to SEC enforcement actions as well as to private suits.

[12] *National Securities* exemplifies a situation likely to recur. The Commission's request for preliminary injunctive relief was denied by the District Court, erroneously as it turned out. Exigencies of time prevented review before consummation, and remitted the Commission to retrospective relief.

as are necessary to make effective the congressional purpose." *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433. It is for this very reason that this Court found "[no] merit in the contention that * * * remedies are limited to prospective relief." 377 U.S. at 434. To withhold any remedy because the merger itself was not enjoined is to circumvent the holding of *Borak*.

5. The decision below makes ineffectual the congressional full-disclosure policy by barring any relief once a merger, later found to be fair, is consummated.

In light of the Court of Appeals' ruling that the undisputed findings would support prospective relief by way of injunction in advance of the meeting (App. 9a), its holding that there is no liability for the consummated merger rests alone upon its expressed reluctance "to unscramble a corporate transaction merely because a violation occurred." App. 12a. No question of "unscrambling", however, was properly before that court. The District Court had postponed for future hearing the question of its duty "to provide such remedies as are necessary to make effective the congressional purpose." *Borak*, 377 U.S. at 433. Petitioner's opportunity to be heard on the form of appropriate relief was foreclosed by the interlocutory appeal, under Section 1292(b) of the Judicial Code, from the District Court's ruling on the issue of liability alone.

Pre-empting this untendered issue, the Court of Appeals adds two unfounded assumptions: that dissolution is the only proper remedy for a consummated merger, and that dissolution is too harsh a remedy for the wrong. Neither assumption can survive examination.

This Court in *Borak* recognized the lower court's choice among a wide range of remedies for a merger

consummated through a violation of the congressional disclosure requirements. "Damages" and "restitution" as well as "rescission" are mentioned by this Court. 377 U.S. at 430, 433. If "unscrambling" should appear, after fair consideration, to be unwarranted, other forms of relief would be available. On the findings affirmed below, petitioners would be entitled, at minimum, to (1) a declaratory judgment that the vote authorizing the merger was illegally obtained[13] (*J. I. Case Co.* v. *Borak,* 377 U.S. 426, 427-28); (2) counsel fees and costs for exposing and establishing this violation of the rights of the corporation and of the minority shareholders and the public (*Sprague* v. *Ticonic National Bank,* 307 U.S. 161, 166-67; *Bakery and Confectionery Workers International U.* v. *Ratner,* 118 U.S. App. D.C. 269, 274, 335 F.2d 691, 696 (D.C. Cir. 1964); (3) an injunction against violations in connection with future proxy statements and transactions (*Labor Board* v. *Express Publishing Co.,* 312 U.S. 426; *Labor Board* v. *Mexia Textile Mills,* 339 U.S. 563, 567-68); (4) an accounting to determine what financial damage, if any, resulted to Autolite and its minority stockholders from the merger (Cf. *Bynum* v. *Baggett Transportation Company,* 228 F.2d 566, 573-74 (5 Cir. 1956); (5) at least nominal damages (Restatement, *Contracts,* § 328, "Nominal Damages"; Restatements, *Torts* § 907 "Nominal Damages," and, perhaps, punitive or exemplary damages. McCormick, DAMAGES, § 81, pp. 290-91. Congress charged the courts to "be alert to provide such remedies as are necessary to make effective the congressional purpose"

[13] In contrast the Court of Appeals held that the petitioners had not established liability although they had proved "that mailing the proxy statement was unlawful", (App. 9a), and thereupon reversed the District Court's declaratory judgment of liability.

(*Borak*, 377 U.S. at 433-34) in *all* cases, not to excuse violations entirely in those cases were "unscrambling" may not be required.

Nor is dissolution foreclosed from consideration as an appropriate form of relief. Far from immunizing violations and barring any remedy, as the court below thought, hypothetical substantive fairness does not even bar undoing the merger. Reserved in *Borak*, that question was answered in *National Securities*. "• • • [T]here is no reason to emasculate the securities law by forbidding remedies which may prove to be essential."

In *Eastside Church*, *supra*, 391 F.2d at 362, the Fifth Circuit, joining the Second,[14] read the "voiding provision" of Section 29(b) as clear indication that Congress intended a "harsh remedy." There is no novelty in this, for courts of equity have long taught that effective enforcement of "insider" obligations, particularly the duty of full and fair disclosure, requires harsh remedies, including upsetting transactions in and of themselves completely fair and equitable. *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, No. 14, this Term, 37 L.W. 4037; *Mosser* v. *Darrow*, 341 U.S. 267, 274-75; *Wolf* v. *Weinstein*, 372 U.S. 633.

This is not to say that substantive merit and fairness are necessarily irrelevant to the issue of restoration of the *status quo ante*. It is to say that desirability of restoration is not, and cannot conceivably be, the touchstone of violation and that injection of the "unscrambling" issue at the violation stage destroys the efficacy of the legislation.

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[14] *Goldstein* v. *Groesbeck*, 142 F.2d 422, 426 (2 Cir. 1944).

CONCLUSION

For the foregoing reasons, the Court should grant this petition for certiorari and reverse the decision below with instructions to enter an order of affirmance, with costs to appellants below.

Respectfully submitted,

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MARCH 10, 1969

APPENDIX

OPINION OF COURT OF APPEALS.

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1967 — APRIL SESSION, 1968

Nos. 16613, 16614

ELMER E. MILLS and LOUIS SUSMAN,

Plaintiffs-Appellees and Appellants,

v.

THE ELECTRIC AUTOLITE COMPANY; MERGENTHALER LINOTYPE COMPANY; AMERICAN MFG. CO., INC.,

Defendants-Appellants and Appellees.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division.

November 25, 1968

Before SWYGERT, FAIRCHILD and KERNER, *Circuit Judges.*

FAIRCHILD, *Circuit Judge.* This is an appeal from an interlocutory summary judgment, determining liability alone, under one of three counts of a complaint. The question of appropriate relief was reserved. The judgment was entered September 26, 1967, an opinion, and findings of fact and conclusions of law, having been filed the same day. Defendants obtained leave to appeal under 28 U.S.C. sec. 1292(b). Plaintiffs, with similar leave, cross appealed from an order entered September 28, 1967 deleting one of the conclusions of law.

The posture of the action.

Plaintiffs attacked a corporate merger whereby The Electric Autolite Company (an Ohio corporation) was to be merged with and into Mergenthaler Linotype Com-

pany. The name of the surviving corporation was changed to Eltra Corporation. The merger was approved at a stockholder's meeting of Autolite on June 27, 1963 and has been treated as effective.

Plaintiffs held stock in Autolite. They assert that this is a derivative action on behalf of Autolite, and also that it is a class action on behalf of themselves and all other minority stockholders.

Plaintiffs filed their original complaint June 26, 1963, the day before the meeting. Their amended complaint, filed February 4, 1964, set out three counts. In each they sought a declaration that the proxies solicited by management were void, orders setting aside the merger and causing the return of assets to Autolite, and an accounting to Autolite for damages. No application was made for a restraining order or temporary injunction to prevent use of the proxies or to delay consummation of the merger.

Count II predicated jurisdiction on sec. 27 of the securities exchange act of 1934.[1] It alleged that the proxy statement sent out by management violated sec. 14(a) of the 1934 act[2] and rule 14a-9, issued under the act,[3] by misrepresentation and nondisclosure; that the proxies obtained were void, and that accordingly the merger had failed to receive valid votes representing the required two-thirds of the Autolite shares.

On November 15, 1965, after a motion by plaintiffs for summary judgment as to count II, the district court filed a memorandum concluding as a matter of law the failure to disclose certain facts was a material omission.

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[1] 15 U.S.C. sec. 78aa.

[2] 15 U.S.C. sec. 78n (a).

[3] 17 C.F.R. 240. 14a-9. "(a) No solicitation subject to this regulation shall be made by means of any proxy statement, notice of meetings or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

The court indicated doubt as to the consequences which must flow from that conclusion. On November 29, the court filed a memorandum opinion and order concluding that there should be a reference to a master under Rule 53(b), F.R. Civ. P. On February 14, 1966, the court filed a memorandum concluding that it would be necessary for the court to determine whether there was a causal connection between the violation of the disclosure requirements and the alleged injury to the plaintiffs before a master should look into appropriate remedial action.

At the time of entering the interlocutory summary judgment appealed from, the court found again that the proxy statement was false and misleading as a result of certain statements and omissions, found that the proxy statement was a cause of the merger, and directed that the master, previously designated, should proceed.

Plaintiffs argue that our present review is limited to the finding of causation, suggesting that the district court's 1965 order or ruling finding a violation of the disclosure rule has passed beyond review. We disagree. Just as defendants could have waited until final judgment and then have attacked on appeal all intermediate orders which involve the merits and necessarily affect the final judgment, so now, upon appeal from the interlocutory judgment they may have review of all prior orders which bear the same relationship to the interlocutory judgment.

Plaintiffs also contend we can not at this time review the order of reference with respect to the determination of relief. They apparently consider that the reference was made November 29, 1965, though suspended thereafter. Although it is true that the judgment entered September 26, 1967 does not expressly direct a reference, the accompanying memorandum makes it plain that the directions given November 29, 1965 were then revived. We consider that the appropriateness of a reference is also before us.

The deficiency in the proxy statement.

Before the merger, Mergenthaler owned 54% of the shares of Autolite outstanding. 46% of the shares were held by 8,987 other shareholders. Under the terms of the merger, the shares owned by Mergenthaler would be canceled. The shares held by others would become preferred stock of Eltra (Mergenthaler), at the ratio of 1.88 shares of preferred stock for each share of Autolite stock. The preferred stock had a par value of $34.50 per share, and would be convertible into common stock of Eltra, at the shareholder's option, share for share for two years, and at less favorable rates thereafter until the end of five years.

Thus in substance, Mergenthaler was offering that if a sufficient number of the minority shareholders of Autolite would vote to approve the merger, all minority common stock interests in Autolite would be transformed into preferred stock interests in the merged companies, with the right of each shareholder, for a time, to transform his preferred stock into Eltra common.

Because Mergenthaler owned 54% of the Autolite shares, it needed the votes of an additional 13% of the shares in order to have the merger approved by a two-thirds vote. The Autolite management solicited proxies, using the proxy statement which is under attack. The merger was approved by votes representing 82% of all the shares, 28% being owned by shareholders other than Mergenthaler.

Although the proxy statement was, in form, addressed to all shareholders, it was, in realistic terms, intended for the minority shareholders. The board of directors recommended a favorable vote, giving emphasis to the recommendation by setting it in larger and bolder type. The question considered by the district court, and decided adversely to defendants as a matter of law, was whether the relationship of the members of the Autolite board to Mergenthaler (and to a third corporation, defendant American Manufacturing Company, Inc.) was sufficiently disclosed.

The key finding was as follows:

> "8. The proxy statement was false and misleading, at the time and in the light of the circumstances under which it was made, in its statement of material facts and in its omission to state material facts necessary to make the statements therein not false or misleading, in its misrepresentation of the supposed independence of the Auto-Lite board and in its failure to inform the shareholders of the interrelationships between the Auto-Lite board and the defendants Mergenthaler and American. These misleading statements and omissions were material in the sense that an average prudent investor ought to be informed of those relationships, in order to bring his own informed and independent judgment to the question of how much weight to give to the Auto-Lite board's endorsement of the merger proposal."

The proxy statement, including financial statements and appendices, was a pamphlet of 108 pages. Statements on pages 2 and 3 indicated that the Autolite board endorsed the merger.

One of these stands out in type which is blacker and larger than the surrounding text. It says: "The Board of Directors has carefully considered and approved the terms of the merger and recommends that the shareholders vote to approve the plan of merger." Elsewhere on page 2 it is said in body type, under "Reasons for Merger": "After a thorough review of all factors involved, both Boards of Directors are of the opinion that the merger would be mutually beneficial to the Constituent Corporations and their respective shareholders." On page 3, under "Basis of Merger", there appears in body type: "The Board of Directors of Electric Autolite believes the plan of merger to be fair and equitable to the shareholders of Electric Autolite; the Board of Directors of Mergenthaler believes the plan of merger to be fair and equitable to the stockholders of Mergenthaler."

Several facts pertinent to the relationship between the eleven members of the Autolite board and Mergenthaler do appear in portions of the proxy statement.

On page 23, it is said that Mergenthaler owns 54% of the outstanding shares, and reference is also made to this fact on page 2, in a statement disclosing Mergenthaler's intention to vote its shares in favor of the merger. On page 23 it appears that four of the eleven Autolite directors are directors of Mergenthaler. One of the four, Mr. Wattles, is chairman of the board of Mergenthaler and chairman of the executive committee of Autolite. Another of the four is an officer of Mergenthaler, receiving substantial remuneration, and will continue to be an officer. Two other Autolite directors are officers of Autolite, receiving substantial remuneration, and will be officers of Eltra. On page 21, it appears that the Eltra board will be expanded to include the seven Autolite directors not on the Mergenthaler board before the merger.

Page 23 also discloses that Mr. Wattles is president and a director of American and owns about one-third of American's stock. American and Wattles together own about one-third of the pre-merger Mergenthaler stock. Three other directors of Mergenthaler are also officers, directors, and shareholders of American.

Thus the proxy statement contains information which would indicate to those aware of corporate mechanism that Mergenthaler had the power to select a majority, if not all, the members of the board, may well have exercised it, and that a minority, at least, were directors of both. Although one reference to Mergenthaler's ownership of 54% of the stock appears on page 2, where the board's recommendation is stated in boldface type, this fact is not given the same emphasis as the recommendation and the other information indicating a close relationship between some of the directors and Mergenthaler appears many pages later.

Plaintiffs produced transcripts of testimony and copies of other papers in a proceeding before the SEC, brought

by American, and terminated two months before the solicitation of the proxies. American had sought and obtained an exemption from provisions of the investment company act of 1940.[4]

Testimony of Mr. Wattles tended to show that the management of American selected directors for Mergenthaler and Autolite, and that Autolite was under the control of American. A statement was submitted to the SEC, dated November 1, 1962 by Mr. Pulleyn, who is a director of all three companies, stating it had been prepared in cooperation with Mr. Wattles. A portion of it is as follows:

> "American desires to state for the record that it continues to control the operations of Mergenthaler and Electric Autolite. The nominees for directors of Mergenthaler are selected by American in consultation with the operating management of Mergenthaler and there is only one director of Mergenthaler (to wit: William J. Flather) who has not been placed on the Board by American. He continues to serve at the pleasure of American. The directors of Electric Autolite are similarly selected. At the present time the Board of Directors of Electric Autolite consists of eleven members. Of these Messrs. Davies, Hiller, Keller, McAlpin, Perkins, Pulleyn and Wattles were and are nominees of Mergenthaler. The other four directors, to wit: Falvey, Harding, Hopkins and Jones were directors prior to the interest of Mergenthaler. These four individuals are kept as directors because in view of their understanding of the affairs of Electric Autolite and their general positions in the community, it is considered in the best interests of Mergenthaler that they continue at this time as directors."

Defendants presented affidavits of every director of Autolite, and each stated that it was his best independent business judgment that the proposed merger would be

[4] 15 U.S.C. sec. 80a-1, et seq.

beneficial to all the shareholders and that no pressure had been exerted in the matter. There was no denial, however, of the facts shown by plaintiffs with respect to selection of the directors by Mergenthaler nor the claim of control of operation generally.

Defendants also presented evidentiary material tending to show that the terms of merger were fair and equitable.

But these two propositions do not demonstrate that there is an issue for trial as to the legal adequacy of the proxy statement. For even if both were established as matters of fact, they would not fully meet the point which is presented.

In a real sense, the merger was a bargain between Mergenthaler and the minority shareholders in Autolite. The Autolite board, selected by their adversary, presumed to advise the minority shareholders to approve the merger. The crucial question at this point, with respect to the policy of the 1934 act, is not whether the advice was good, but whether the minority shareholders were sufficiently alerted to the board's relationship to their adversary to be on their guard.

It is true that approval of the merger by the board was an essential step in effecting the merger. Had the proxy statement simply reported approval, without emphasis and along with the other facts, we might have a different situation. But the Autolite management was not content with a bland statement that the board had approved. The language used in a communication which was really intended for the minority shareholders implied that the board was giving disinterested advice. Statements appearing on pages 2 and 3, one of them emphasized by the use of larger and heavier type, doubtless got the attention of some shareholders who did not read pages 21 and 23.[5] We think that under the circumstances the

[5] "The language used and the position and emphasis given to each statement, . . . may be considered in determining whether there has been a fair and candid disclosure of a material fact. . . ." *Richland* v. *Crandall* (S.D.N.Y. 1967), 262 F. Supp. 538, 554.

board was not free to state its recommendation and opinion favoring the merger without giving similar emphasis to the relationship between the directors and the other party to the bargain.

Statements in *S.E.C.* v. *Capital Gains Bureau*[6] offer guidance here though decided under the investment advisers act of 1940.[7] The Supreme Court said: "The statute, in recognition of the adviser's fiduciary relationship to his clients, requires that his advice be disinterested. To insure this it empowers the courts to require disclosure of material facts. It misconceives the purpose of the statute to confine its application to 'dishonest' as opposed to 'honest' motives. . . . The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients." The Court cited with approval a 1936 district court holding under the '33 act[8] "that suppression of information material to an evaluation of the disinterestedness of investment advice 'operated as a deceit on purchasers.' 15 F.Supp., at 317."

We conclude, in agreement with the district court, that as a matter of law the proxy statement failed, in connection with the advice tendered by the board, adequately to bring out the relationship between the board members and Mergenthaler. This, in terms of the rule, was an omission of a material fact necessary in order to make the statements therein not misleading. It follows that mailing the proxy statement was unlawful under 15 U.S.C. sec 78n (a) (sec. 14(a)). We have no question but that, if an injunction had been timely sought in advance of the shareholders' meeting for which the proxies were solicited, corrective measures would have been appropriate.

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[6] (1963), 375 U.S. 180, 201, 84 S.Ct. 275, 11 L.Ed.2d 237.

[7] 15 U.S.C. sec. 80b-1, et seq.

[8] *Securities & Exchange Comm'n* v. *Torr* (S.D.N.Y. 1936), 15 F.Supp. 315.

The causal relationship and appropriate relief.

In this case, although the action was filed one day before the merger, the matter did not really come before the court until too late for preventive action. The court must now determine in retrospect whether the unlawful act caused some inequity or damage which the court should relieve or redress.

It is clear that the merger required favorable votes representing at least two-thirds of the Autolite shares, and that in order to count a two-thirds vote, one must include votes which were cast by authority of proxies obtained by the challenged solicitation. The district court concluded that since this is so, the proxy statement was a cause of the merger and defendants' "liability" followed as a matter of law. Relief was left for further consideration after hearings before a special master and a report thereon.

Plaintiffs held, between them, only 5/100 of 1% of the Autolite shares, and voted against the merger, as did other holders of about 4% of the shares. Nothing in the record indicates dissatisfaction with the merger on the part of any shareholders who voted for it (the holders of 28% in addition to Mergenthaler).

Plaintiffs appear to contend that Autolite had a right to a separate existence which the court must vindicate against unlawful interference, and claim their own rights to be shareholders of Autolite, unaffected by votes at a meeting where the information supplied to the electorate did not meet the standards of the 1934 act. They seem to argue that the proxies were void because of the deficiency in the proxy statement, and that the merger is void because it did not receive enough valid votes.[9]

We think however that there is an issue for trial with respect to the causal relationship between the deficiency in the proxy statement and the merger. It follows that

[9] 15 U.S.C. sec. 78cc.

summary judgment was improper with respect to this issue.

Defendants presented evidentiary material tending to show that the merger has merit and the terms were in fact fair and equitable to the minority shareholders; that before the proxy statement was issued research consultants made an independent study and reported favorably. This report was referred to in the proxy statement. Although we have concluded that this material did not raise an issue for trial as to whether there was a material omission, we think it does bear on the cause question.

Plaintiffs and the district court deem liability established because some of the required votes depended for validity on proxies secured by the unlawful proxy statement. We think the more exact question is whether the misleading statement and omission caused the submission of sufficient proxies.[10]

The material offered by defendants on the merits of the terms of merger suggests that it may be possible for them to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found.[11] It seems fair to place the burden of persuasion on this issue on defendants, who are responsible for the violation, but if they are able to carry the burden, there would be no sound basis for disruption of the merger or other relief. We do not consider that the policy of the '34 act requires the court

[10] In common law fraud terms, the corresponding question would be whether the injured party relied on the misrepresentation. Reliance by thousands of individuals, as here, can scarcely be inquired into. In *J. I. Case Co.* v. *Borak* (1963), 377 U.S. 426, 431, the issue is referred to as "the causal relationship of the proxy material and the merger." The complaining stockholder pleaded in that case that the merger would not have been approved "but for" the false and misleading statements in the proxy solicitation material.

[11] See *Union Pacific R. Co.* v. *Chicago and Northwestern Ry. Co.* (N.D.Ill. 1964), 226 F.Supp. 400, 411, putting the matter in terms of probability.

to unscramble a corporate transaction merely because a violation occurred.[12]

Therefore we conclude that there is an issue for trial as to the causal relationship. The interlocutory summary judgment should not have been entered, although we agree with the district court as a matter of law that in the light of the board's statements recommending and giving opinions favorable to the merger the failure to give similar emphasis to the relationship with Mergenthaler was the omission of a material fact necessary to make the laudatory statements not misleading.

The reference to a master appears to have embraced, without guidelines or restrictions by the court, the entire issue as to relief to be granted. The present order of reference will fall along with the reversal of the judgment, and it is unnecessary to do more than to note that there is doubt whether the reference of so broad an issue was justified under Rule 53(b), F.R. Civ. P.

The district court, on September 28, 1967, struck out a conclusion that the merger was void. Had this conclusion been left standing, it would have fallen along with reversal of the judgment. We affirm the September 28 order on that basis, without considering the merits of the conclusion of voidness if the judgment had been affirmed.

The judgment entered September 26, 1967 is reversed and the cause remanded for further proceedings. The order entered September 28, 1967 and appealed from by plaintiffs is affirmed.

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[12] See, however, *Laurenzano* v. *Einbender* (E.D.N.Y. 1966), 264 F.Supp. 356, 360. The test there stated for denying motion to dismiss for want of jurisdiction is that the accused proxy material "have a transactional function and not merely be randomly present in the context of the transaction with respect to which a remedy is sought." The decision acknowledges, however, that once jurisdiction is accepted, "Much must depend on the facts."

JUDGMENT OF COURT OF APPEALS.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604
Monday, November 25, 1968
Before
Hon. LUTHER M. SWYGERT, *Circuit Judge*
Hon. THOMAS E. FAIRCHILD, *Circuit Judge*
Hon. OTTO KERNER, *Circuit Judge*

ELMER E. MILLS and LOUIS SUSMAN,
Plaintiffs-Appellees and Appellants,

No. 16613, 16614

vs.

THE ELECTRIC AUTOLITE COMPANY, et al.,
Defendants-Appellants and Appellees.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court entered September 26, 1967, in this cause appealed from be, and the same is hereby, REVERSED, and that this cause be, and it is hereby REMANDED to the said District Court for further proceedings in accordance with the opinion of this Court filed this day.

It is further ordered and adjudged by this Court that the order of the said District Court entered September 28, 1967 and appealed from by plaintiffs be, and the same is hereby, AFFIRMED.

It is further ordered and adjudged by this Court that the costs in those appeals be taxed in favor of defendants, The Electric Autolite Company, et al.

AFFIDAVIT OF PRINTING COSTS.

JEROLD S. SOLOVY, being first duly sworn on oath deposes and says that he is one of the attorneys for defendants-appellants in the above captioned matter, that he participated in the preparation and filing of appellants' brief and appendix in this cause and that appellants' costs in printing said appendix were $8,846.45. The invoice from United States Law Printing Company to affiant for printing said appendix is attached as an exhibit to this affidavit.

OPINION OF DISTRICT COURT

Memorandum, Opinion and Order, dated September 26, 1967:

I am again called upon to contribute an increment to the Federal Common Law of Corporations as derived from judicial exegesis of the Securities and Exchange Acts. This cause involves Section 14 of the 1934 Act and Rule 14a-9 as affecting omissions in Proxy Statements with regard to a corporate merger. The issue before me is the existence of a causal connection of the omissions and the merger.

The case involves a derivative class action brought on behalf of minority stockholders who have challenged the merger of Electric Auto-Lite Company, herein referred to as "Auto-Lite", with Mergenthaler Linotype Company, herein referred to as "Mergenthaler", by alleging that the Proxy Statement contained certain omissions.

The complaint alleges that the Proxy Statement failed to reveal, in soliciting a two-thirds stockholders' vote for the merger, that the directors of both Mergenthaler and Auto-Lite were controlled by a third company, American Manufacturing Company. The defendants' answer failed to deny these allegations and the plaintiffs moved for summary judgment pursuant to Rule 56. I had granted the motion for summary judgment and the remaining issue

is whether there was a causal connection between the omissions in the Proxy Statement and the merger.

In the hearing which I conducted, and considering the facts as revealed from the record before me, I find that this case involves a merger between Electric Auto-Lite Company and Mergenthaler Linotype Company.

Auto-Lite, though its principal place of business is in Ohio, has plants in over a score of states, including Illinois, Indiana and Michigan. In 1963, it had approximately 29 plants throughout the United States and Canada. Auto-Lite and its subsidiaries are principally engaged in manufacturing automotive electrical equipment, light helicopters, industrial batteries and instruments. Also, through its wholly owned subsidiaries, it is engaged in leasing industrial and business equipment. In 1962, the total net sales were $180,863,539. It had engaged in a policy of constantly acquiring smaller corporations and consolidating and expanding its activities.

Mergenthaler and its subsidiaries are engaged in the production and distribution of linotype machines and parts, Linofilm systems, and other printing equipment, and in the design and manufacture of military equipment. In 1962, it had net sales of $240,092,891, and distributes its products through sales offices in Atlanta, Boston, Chicago, Dallas, Los Angeles, New York and San Francisco. Distribution outside the United States is handled by foreign subsidiaries and a worldwide network of 57 distributors with offices in 11 countries.

Eltra Corporation, the merged entity, exists as a holding company to control the two, and thus both, presumably, would be engaged in the activity of determining major policy matters relating to automobile batteries, helicopters, the leasing of industrial equipment, the leasing of business machine equipment, the manufacture, distribution and maintenance of linotype and other printing machines and equipment, and the planning, manufacturing and distribu-

tion of various types of equipment used by our armed services in the United States and throughout much of the rest of the world. The merged entity has evolved into a leviathan which consumes smaller corporate giants and has thus attained the power to substantially affect the course of the national economy.

The Supreme Court in *J. I. Case* v. *Borak,* 377 U.S. 426 (1964) had established the right of private enforcement of Section 14a, and held that such a suit may be individual or derivative. The Federal Court also is given jurisdiction to grant relief. However, Mr. Justice Clark's opinion contained the following enigmatic statement:

> It appears clear that private parties have a right under §27 to bring suit for violation of §14(a) of the Act. Indeed, this section specifically grants the appropriate District Courts jurisdiction over "all suits in equity and actions at law brought to enforce any liability or duty created" under the Act. The petitioners make no concessions, however, emphasizing that Congress made no specific reference to a private right of action in §14(a); that, in any event, the right would not extend to derivative suits and should be limited to prospective relief only. In addition, some of the petitioners argue that the merger can be dissolved only if it was fraudulent or non-beneficial, issues upon which the proxy material would not bear. *But the causal relationship of the proxy material and the merger are questions of fact to be resolved at trial, not here. We therefore do not discuss this point further.* 377 U.S. at 431, emphasis added.

No reference to this issue is made in the Seventh Circuit decision, *Borak* v. *J. I. Case,* 317 F.2d 838 (7th Cir. 1963), nor in the order of the District Court, Civil Action File No. 56 C 247 (E.D. Wisconsin, 1956). Indeed, the Plaintiff-Respondent's brief asserted that the causal connection problem was not present. *Brief of Plaintiff-Respondent,* p. 37.

The Court in *Borak* did find that a corporate merger could be attacked on the basis of a new Federal cause of action created by Section 14(a). However, while an action brought under Section 10(b)—wherein the plaintiff seeks a money judgment to restore him to his prior position—is a private action, a Section 14 action is for enforcement of the statute since there may be no monetary recompense. As a derivative suit the action asserts the right of the corporation when the corporation refuses to assert that right itself. Comment, *Private Rights and Federal Remedies: Herein of J. L. Case* v. *Borak,* 12 UCLA L. Rev., 1161-7 (1966).

The motivating consideration is the protection of investors with private enforcement providing a supplement to Commission action with enforcement in the individual as well as the corporation. *Id.* 1168. However, because *Borak* was a decision based upon pleadings, brought by a plaintiff whose ownership was contemporaneous with the wrong alleged, the Court was not faced with the task of formulating new Federal standards to govern controverted factual issues. One such fact issue is the question of causality. The question is left to the lower Federal Courts for determination.

A principal result of the *Borak* decision is that the lower Federal Courts have been given the mandate to further develop a Federal Common Law of Corporations. Since an action under Section 14 is for enforcement rather than to effectuate a private right, the Courts must be guided by overriding national policy involving considerations of the good of the economy, which may predominate over a puritanical concern for corporate honesty, as well as a concern for the protection of the investor. Since the action may be taken on behalf of the corporation, its interests may predominate over that of the individual investor. Within this context, I find that a causal connection existed in the present case between the omissions in the Proxy Statement and the merger.

Since the *Borak* decision, Federal Courts have had occasion to consider the issue of causality. However, a number of these cases involved the presence of intervening factors so that the omissions or misstatements did not affect the merger.

In *Barnett* v. *Anaconda Company,* 238 F.Supp. 766 (S.D.N.Y. 1965), the Court held that the complaint failed to assert a causal connection between the statements in the Proxy Statement and the merger. However, the approval of the merger was a foregone conclusion, since the defendant owned more than the necessary number of shares to effectuate the merger. The Court reasoned that the merger would have been effectuated without the misleading statements. The decision, however, has been criticized in a law review note, which observes that the plaintiff was seeking not only rescission, but also damages suffered from the denial of his right to receive full value for his shares. This right is particularly in need for protection when the majority stockholder authorizing the sale is also the buyer. Delaware law, which was relevant in that case, provides that directors and majority stockholders have a fiduciary obligation to stockholders so that the defendant, as a majority stockholder would have been obliged to arrange the best possible terms in the sale and dissolution of the corporation's assets. Therefore, if the defendant's failure to provide pertinent proxy information violated Section 14, preventing the minority stockholders from protecting the true stock value, the necessary causal connection was present. Because of this misleading information, plaintiff's ability to enjoin the sale and dissolution under Delaware law, thereby protecting the value of his stock, may have been seriously impaired. Comment, 51 Iowa L. Rev. 515, 521 (1966).

In *Hoover* v. *Allen,* 231 F.Supp. 231 (S.D. N.Y. 1965) a causal connection was absent because the complaint failed to allege that the misleading statements affected the corporation adversely. Moreover, no merger was involved.

In *Eagle* v. *Horvath,* 241 F.Supp. 341 (S.D. N.Y. 1965), the Court, in denying defendants' motion for summary judgment, found that "As a matter of law . . . defendants did not control the requisite two-thirds of both classes of [certain] stock issued and outstanding at the time of the alleged violations . . ." Though the defendants had the necessary two-thirds control of the common stock, they had less than two-thirds of the preferred shares. Though they could redeem the preferred, they had not done so. The case is unclear as to what facts were presented and as to whether a summary judgment by the plaintiffs would have been granted.

No causal connection was found in *Cohen* v. *Colvin, et al.,* 266 F.Supp. 677 (1967), where the alleged benefit to the defendant occurred before the issuance of the Proxy Statement containing the false statements and omissions and the corporation was not adversely affected.

In *Laurenzano* v. *Einbender,* 264 F.Supp. 356, E.D. N.Y. (1966), Judge Dooling was troubled as to whether the doctrine of *Barnett* v. *Anaconda, supra,* be accepted and directed an immediate appeal of this question. He suggested that a causal connection might be inferred where, though the proxy statement was not a necessary or indispensable ingredient of the transaction, it was "calculatedly infused into the matrix of the transaction".

The cases appear to indicate that for a causal connection to exist the misrepresentations or omissions in the proxy statements must have a transactional function involving corporate action. *Laurenzano* v. *Einbender, supra.* The proxy statement must not be merely "randomly present" in the context of the transaction with no transactional function. *Cohen* v. *Colvin, supra; Hoover* v. *Allen, supra; Robbins* v. *Banner Industries, Inc.,* CCH Fed. Sec. L. Rep. Par. 91, 861, pp. 95, 950 (S.D. N.Y. 1966).

Where the accused proxy material is not merely "randomly present" in the context of the transaction, a causal relationship is established as intimate and direct, particu-

larly where a merger is involved. *Laurenzano* v. *Einbender, supra.* Such a direct causal relationship exists in the present case.

When false or misleading solicitation material has been used to secure stockholder approval of plans conferring pensions, bonuses or stock options to defendant directors relief appears well grounded. In those instances in which a plan would clearly have failed had the stockholders known the true facts, the plan may be terminated or rescinded with recoupment of any benefits previously conferred. Comment, *supra,* 12 UCLA L.Rev. 1150, 1181 (1966).

The cases which have considered the issue of causality have ignored the fact that an action under Section 14 is for enforcement. I had conducted a hearing to make a factual determination of the issue of causality, proceeding under the assumption that such a determination must be made as that suggested by the cases discussed above. But, after fully considering these cases and the opinion in *Borak,* along with the facts presented at the hearing, I have decided that *Borak* implies a different approach.

The *Borak* decision, by conferring upon the Federal Courts the authority to determine what type of relief may be granted for federally created rights, placed the Courts in a position where they may affect the national economy. As in *Textile Workers* v. *Lincoln Mills,* 353 U.S. 448 (1957), in the field of labor relations, the Federal Courts are now authorized to fashion a body of Federal Law for the enforcement of regulations of proxy solicitation. The Federal Courts may borrow from state law. But this development of Federal Common Law will grow on an *ad hoc* basis.

The course of development will be based upon a consideration of the needs of the national economy. In *Borak,* the plaintiff is given a right to sue derivatively under Section 14 in order to enforce the Securities and Exchange

Act for the good of the corporation and the benefit of the economy.

Causal connection must be decided within this context. Finding a causal relationship is finding *prima facie* that the circumstances surrounding the merger are not in the interests of the national economy as it relates to the industries involved in the merger, so as to justify a derivative suit to prevent an existing corporation from evolving into the type of corporate structure which should not exist. From the evidence I have before me, I am convinced that the areas of industrial activity linked by the merger are so inherently unrelated as to cause the new corporation to fall in that category of business enterprises as referred to recently by the Supreme Court as constituting a conglomerate merger, and to be inherently dangerous to a healthy economy. *United States* v. *Von's Grocery*, 384 U.S. 270 (1965); *Federal Trade Commission* v. *Proctor & Gamble Co.*, 386 U.S. 568 (1966); Rill, *Conglomerate Mergers: The Problem of Super Concentration*, 14 UCLA L. Rev. 947.

That finding being today completed and made, I am now able to proceed to complete my ruling on plaintiffs' motion for summary judgment and grant the motion and it is so ordered. The Master heretofore appointed by this Court to proceed with those matters resulting upon this order, but whose direction to proceed was held up by order of this Court pending the further determination of plaintiffs' motion for summary judgment, is now hereby directed to proceed forthwith. Quoting from my interim order of November 29, 1965, and redirecting the Master in the same language, I herein direct as follows:

(1) The Master shall act as his own counsel, but may use members and associates of his firm to assist him in his duties. He may employ such accountants and experts as he may deem necessary, but before doing so shall file an application with this Court for approval of such employment.

(2) The Master shall have the right to examine any and all corporate documents of Eltra, Mergenthaler and Auto-Lite as he may deem necessary, including, without limiting the foregoing, minute books, correspondence, proxy statements, annual reports, contracts and financial statements.

(3) The Master is authorized to hold such hearings, upon notice, as he may deem necessary, to take the testimony of the Officers and Directors of the above corporations, and to employ Court Reporters to take such testimony and transcribe the same. The Master shall file such testimony with his report thereon, with this Court.

(4) The Master shall perform such other duties as the Court shall order and direct, and shall generally perform such duties as are performed by Masters in Chancery in similar matters.

(5) In order to expedite the disposition of this litigation, the Court hereby directs the Master to make a preliminary report to this Court as promptly as possible.

The order entered today formally setting forth Findings of Fact and Granting Motion for Summary Judgment are incorporated herein by reference.

FINDINGS OF FACT AND CONCLUSIONS OF LAW OF DISTRICT COURT.

Findings of Fact:

Upon the motion of the Plaintiffs herein for the entry of Supplemental Summary Judgment in their favor upon the claim set forth in Count II of the Amended and Supplemental Complaint, the Court finds, upon consideration of the pleadings and the admissions contained therein, the affidavits and exhibits offered in support of the motion, the Responses of the Defendants to Requests to Admit submitted by the Plaintiffs, the documents produced by the Defendants in compliance with orders for the production of documents herein, the testimony and ex-

hibits herein received, and the record in this action, that there is no genuine issue as to the following material facts:

1. This is a derivative class action brought on behalf of The Electric Auto-Lite Company (Auto-Lite) and of its shareholders as a class. Auto-Lite was, at the time of the commencement of this action on June 26, 1963, a corporation incorporated under the laws of Ohio and maintained its principal place of business in that state. Plaintiff Elmer E. Mills is a citizen and resident of the state of Illinois, and was the owner of 100 shares of the common stock of Auto-Lite at the time of the transaction complained of and since May, 1961. Plaintiff Louis Susman is a citizen and resident of the state of Illinois, and was the owner of 500 shares of the common stock of Auto-Lite at the time of the transaction complained of and since April, 1957. Both plaintiffs have acted in good faith in the prosecution of this action, and fairly insure the adequate representation of the interests of Auto-Lite and of the other stockholders as a class; the action is not a collusive one brought to confer jurisdiction on the Court. The shareholders of Auto-Lite, numbering some 8,987 record owners, are so numerous as to make it impracticable to bring them all before the Court.

2. On June 26, 1963, Auto-Lite and its subsidiaries constituted a going concern, profitably engaged in the manufacture and sale of automotive electrical equipment. light helicopters, industrial batteries and instruments, with some 24 plants in the United States and Canada. On June 27, 1963, the entire outstanding stock of Auto-Lite consisted of 1,160,565 shares of common stock, par value $5, registered on the New York Stock Exchange.

3. The defendant Mergenthaler Linotype Company (Mergenthaler), on June 26, 1963, was a New York corporation principally engaged in the production and distribution of Linotype machines and other graphic arts equipment, and in the design and manufacture of military

equipment. On June 27, 1963, the entire outstanding stock of Mergenthaler consisted of approximately 2,700,688 shares of common stock, par value, $.25, and Mergenthaler owned over 50% of Auto-Lite's outstanding common stock. Since at least March, 1962, Mergenthaler had been in control of Auto-Lite by virtue of its stock ownership.

4. The defendant American Manufacturing Company (American), a Delaware corporation maintaining its principal place of business in New York, owned approximately one-third of the outstanding shares of Mergenthaler on June 26, 1963. Since at least March, 1962, American had been in control of Mergenthaler by virtue of its stock ownership.

5. The president of American, Mr. Gurdon Wattles, owned approximately 34.13% of American's voting stock, and was both a director and chairman of the board of Mergenthaler and a director and chairman of the executive committee of Auto-Lite.

6. Under date of May 29, 1963, Mergenthaler caused Auto-Lite to send to Auto-Lite shareholders, through the United States mails, a notice and proxy statement pertaining to a special meeting to be held on June 27, 1963, in Toledo, Ohio, to consider the merger of Auto-Lite and Mergenthaler. The proxy statement recited:

> "The Board of Directors has carefully considered and approved the terms of the merger and recommends that the shareholders vote to approve the plan of merger.
>
> "After a thorough review of all factors, both Boards of Directors are of the opinion that the merger would be mutually beneficial to the constituent corporations and their respective shareholders."

7. The proxy statement does not disclose that on November 2, 1962, in order to secure exemption from the Investment Company Act of 1940, the defendants stated for the record before the Securities and Exchange Com-

mission that American "continues to control the operations of Mergenthaler and Electric Auto-Lite" with seven of the eleven directors of Auto-Lite nominated by Mergenthaler and four held over as a matter of sufferance "in the best interests" of Mergenthaler.

8. The proxy statement was false and misleading, at the time and in the light of the circumstances under which it was made, in its statement of material facts and in its omission to state material facts necessary to make the statements therein not false or misleading, in its misrepresentation of the supposed independence of the Auto-Lite board and in its failure to inform the shareholders of the interrelationships between the Auto-Lite board and the defendants Mergenthaler and American. These misleading statements and omissions were material in the sense that an average prudent investor ought to be informed of those relationships, in order to bring his own informed and independent judgment to the question of how much weight to give to the Auto-Lite board's endorsement of the merger proposal.

9. Under the terms of the merger agreement, an affirmative vote of two-thirds of the shares of Auto-Lite was required for approval of the merger. The defendants owned and controlled less than two-thirds of these shares, or slightly more than 54%, and approval of the merger required approval from the owners of 141,730 shares of those not controlled by the defendants. In response to the mailing of the proxy statement, approximately 5,490 executed proxies were received from the 8,987 shareholders, of record of Auto-Lite on May 29, 1963. At the June 27, 1963 meeting, all votes concerning the proposed merger were cast wholly by proxy, including the votes of 317,291 shares cast in favor of the agreement through proxies from shareholders other than the defendants. A total of 949,271 shares were voted in favor of the merger, and 48,450 shares were voted against it. The proxies given by independent stockholders in response to the proxy

statement were necessary and indispensable to the approval of the merger.

10. No communication was sent to the shareholders of Auto-Lite in advance of the meeting of June 27, 1963, by the defendants or any other person, which corrected the misleading statements and omissions of the proxy statement. No disclosure was made by the defendants or any other person during the meeting of June 27, 1963, which corrected the misleading statements and omissions of the proxy statement. Six shareholders not officers or directors of the defendants attended the meeting of June 27, 1963, and represented about 500 shares; all voting on the merger was by proxy. Any disclosure at the meeting would have had no substantial effect on the misleading influence of the proxy statement. The misleading proxy statement was a direct and intimate cause of the merger, and a functional and necessary element in the merger transaction.

11. Pursuant to the vote by proxies submitted by mail in response to the proxy statement, the defendants have taken purported steps to effectuate the merger, including the extinguishment of Auto-Lite's corporate existence and the diminution of the percentage of the minority shareholders' equity in the business therefore conducted by Auto-Lite.

12. Since the officers and directors of Auto-Lite and Mergenthaler, as its principal shareholder, participated in the wrongful activities, and would have been compelled to act against their interests to correct the wrong, any demand upon them to rectify the wrongs would have been futile.

Conclusions of Law:

1. The Court has jurisdiction of the subject matter of the action under Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78aa.

2. The plaintiffs have standing to maintain this action. *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964).

3. The defendants have committed a violation of Section 14 of the Securities Exchange Act of 1934, and of Rule 14a-9 issued by the Securities and Exchange Commission pursuant to that Section, by issuing a proxy statement which, at the time and in the light of the circumstances under which it was made, was false and misleading in its statements of material facts and in its omission of material facts necessary to make the statements therein not false and misleading.

4. The proxy material, as a matter of law and fact, was a direct and intimate cause of the merger of Auto-Lite and Mergenthaler.

5. Under the provisions of Section 29(b) of the Securities Exchange Act of 1934, the merger effectuated through a violation of Section 14 of the Act is void.

6. Since no genuine issue of material fact exists on the question of the defendants' liability, the plaintiffs are entitled to the entry of summary judgment in their favor on the issue of liability under Count II of their Complaint, and to such relief as may appear to be appropriate and just in further proceedings to be conducted in this action.

ORDER OF DISTRICT COURT.

Order Granting Motion for Summary Judgment, dated September 26, 1967:

This cause having come on to be heard on motion of the plaintiffs for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure; and the Court having considered the pleadings in the action, the admissions of the defendants made in response to the plaintiffs' requests to admit, the documents produced by the defendants pursuant to order of Court entered under Rule 34, the affidavits and exhibits submitted in support

of the motion, and the testimony and exhibits presented in hearings in the action, and having considered the briefs and arguments of counsel; and the Court having heretofore entered its Findings of Fact and Conclusions of Law, setting forth facts which are not the subject of substantial controversy, and finding the plaintiffs to be entitled to judgment as a matter of law, it is hereby

ORDERED, that plaintiff's motion for summary judgment as supplemented is in all respects granted, and it is further

ORDERED, ADJUDGED and DECREED that judgment be and hereby is entered for the plaintiffs herein upon the claim set forth in Count II of the Amended and Supplemental Complaint, the defendants being liable thereunder, for such relief as may be just and appropriate as determined by further order of this Court.

AMENDMENT OF ORDER OF DISTRICT COURT.

Order of Court, dated September 28, 1967:

Oral motion of defendant, without waiver of right to object to other findings and conclusions, for an immediate expunging of Par. 5 of the Conclusions of Law entered September 26, 1967, is argued and allowed.

Enter order nunc pro tunc as of September 26, 1967 striking Par. 5 from the conclusions of law and numbering Par. 6 Par. 5.

OPINION OF DISTRICT COURT OF NOVEMBER 15, 1965.

Memorandum Opinion, dated November 15, 1965, granting Summary Judgment as to Count II of the Amended and Supplemental Complaint:

This is a derivative class action brought on behalf of minority stockholders of Electric Auto-Lite Company ("Auto-Lite") against Auto-Lite and two other corporations, Mergenthaler Linotype Company ("Mergenthaler")

and American Manufacturing Company ("American Manufacturing").

In a proxy statement issued on May 29, 1963, defendants, Auto-Lite and Mergenthaler, proposed a corporate merger. At the time of the filing of this action, Auto-Lite was an Ohio corporation and through its subsidiaries it operated a successful business principally engaged in manufacturing automotive electrical equipment, light helicopters, industrial batteries and instruments. Through its wholly owned subsidiaries, it engaged in leasing industrial and business equipment. It had approximately 29 plants throughout the United States and Canada. On June 27, 1963, the entire outstanding capital stock of Auto-Lite consisted of 1,159,265 shares of common stock, par value $5.

Mergenthaler, a New York corporation, and its subsidiaries (other than Auto-Lite) were principally engaged in the production and distribution of Linotype machines and other graphic arts equipment, and in the design and manufacture of military equipment. On June 27, 1963, the entire outstanding capital stock of Mergenthaler consisted of 2,700,638 shares of common stock, par value $0.25 and Mergenthaler owned over fifty per cent (50%) of the outstanding common shares of Auto-Lite. As determined by the Securities and Exchange Commission, for two years prior to that date, Mergenthaler had been in control of Auto-Lite by virtue of its stock ownership.

American Manufacturing, a Delaware corporation, maintaining its principal place of business in New York, owned approximately one-third of the outstanding shares of Mergenthaler on June 26, 1963. The Securities and Exchange Commission determined that American Manufacturing had been in control of Mergenthaler by virtue of its stock ownership and through Mergenthaler American Manufacturing controlled Auto-Lite.

The President of American Manufacturing, a Mr. Gurdon Wattles, owned approximately 34.13% of the voting

stock of American Manufacturing. He was also a director and Chairman of the Board of Mergenthaler and Chairman of the Executive Committee of Auto-Lite.

Mergenthaler began to acquire shares of Auto-Lite on the open market. By August, 1961, Mergenthaler had acquired approximately one-third of the outstanding shares of Auto-Lite, had taken over control of Auto-Lite, had selected a majority of Auto-Lite's directors and named the executive officers. By 1962, all eleven directors of Auto-Lite had been selected by Mergenthaler. Seven Auto-Lite directors, Davies, Garber, Hiller, Keller, McAlpin, Pulleyn and Wattles were placed on Auto-Lite's board by Mergenthaler, and the other four Auto-Lite directors, Falvey, Harding, Hopkins and Jones were holdovers from the period prior to Mergenthaler's control and retained their positions as directors. After March, 1962, Mergenthaler owned over 50% of the outstanding shares of Auto-Lite.

During the time that Mergenthaler was acquiring shares of Auto-Lite on the open market, Auto-Lite acquired at least 345,000 shares of Auto-Lite stock, bringing Auto-Lite's total purchases of its own stock to 630,050 shares (approximately one-third of all its issued and outstanding shares) at a total cost to Auto-Lite for said 630,050 shares of approximately $37,000,000 of which over $20,000,000 was expended for the shares acquired in and after July, 1961. These shares were acquired at prices substantially below the net asset value per share. The effect of the acquisition by Auto-Lite of its own shares was to increase Mergenthaler's percentage ownership of Auto-Lite stock to more than 50%.

In March, 1963, American Manufacturing obtained an order from the Securities and Exchange Commission exempting it from the provisions of the Investment Company Act of 1940. It contended before the Commission that its primary activity was not investing in securities, but rather that it was a holding company conducting the

business of its controlled companies. To prove that these were controlled companies, it was necessary for American Manufacturing to establish that it exercised a controlling influence over the management and policies of Mergenthaler and Auto-Lite. [Section 2(a)(9) of the Investment Company Act.]

Testimony and written statements described below were submitted to the Commission in those proceedings to show that all of the directors and the principal executive officers of Mergenthaler, and through it the board of Auto-Lite, were controlled by American Manufacturing. These exhibits are filed in support of plaintiffs' motion for summary judgment on Count II of the Amended and Supplemental Complaint.

1. In the matter of Century Investors, Inc., et al., Docket No. 812-1300-1, Applicant's Exhibit No. 65. Memorandum in support of application for exemption from Investment Company Act under Section 3(b)(2) thereof submitted by Simpson, Thacher and Bartlett, attorneys for American Manufacturing Company, Inc.

2. In the matter of American Manufacturing Company, Inc., Docket No. 812-1300, Exhibit No. 65(a).

   American Manufacturing Company, Inc. memorandum in support of application of American Manufacturing Company, Inc., for exemption pursuant to Section 3(b)(2) of the Investment Company Act of 1940.

3. Transcript of testimony taken before the Securities and Exchange Commission in Washington, D. C., in Docket No. 812-1300-1-2, Volume 1, consisting of testimony given July 7, 1960 and comprised of pages 1 through 130, and Volume 3 consisting of testimony given on August 2, 1961, comprised of pages 194 through 285.

The complaint charges that according to the terms of the proposed merger, the business and assets of Auto-Lite having a book value of $102 million would be acquired by Mergenthaler for about $75 million.

It is alleged that minority stockholders of Auto-Lite would suffer severe financial losses upon consummation of the proposed merger since they would give up their equity in Auto-Lite in return for a new issue of convertible preferred stock in the surviving corporation with an aggregate par value of $12.5 million less than the book value of their equity in Auto-Lite.

The complaint charges that Mergenthaler caused Auto-Lite to send to shareholders of Auto-Lite a false and misleading proxy statement in order to obtain the necessary number of proxies to satisfy the terms of the merger agreement and the Ohio Corporation Law. The proxy statement, at Page 2 thereof, provides:

> "The merger is subject . . . to the prior approval of the holders of at least two-thirds of the outstanding Common Shares of Electric Autolite at the special meeting of shareholders to which this Proxy Statement relates."

Article IX of the Agreement of Merger provides as follows:

> "CONDITIONS PRECEDENT TO AGREEMENT OF MERGER
>
> 2. The obligation of Electric Autolite under this Agreement of Merger shall be subject to the existence of the following conditions . . .
>
> (g) This Agreement of Merger shall have been approved by the affirmative vote of the holders of not less than two-thirds of the outstanding . . . Common Shares of Electric Autolite."

After the proxy solicitation, the Directors of Auto-Lite received the requisite number of votes in favor of the merger and it was consummated.

The complaint is in three counts. Count I alleges common law fraud. Count II charges a violation of Section 14(a) and Section 29(b) of the Securities Exchange Act of 1934 and Rule 14a-9 thereunder. Count III asserts that the merger is *ultra vires* under Ohio Law.

Jurisdiction over Count II is based upon the Securities Exchange Act of 1934, while as to Counts I and III, the amended complaint alleges that there is diversity of citizenship and the amount in controversy exceeds $10,000. The action is brought in equity. The plaintiffs seek to have the proxies declared void, the merger set aside, and other appropriate relief.

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, plaintiffs move the Court for the entry of a summary judgment in plaintiffs favor for the relief demanded in Count II in the Amended and Supplemental Complaint on the ground that there is no genuine issue as to any material fact and that plaintiffs are entitled to judgment as a matter of law.

Plaintiffs have filed, as Exhibit 4, the Findings and Opinion of the Commission in the proceedings. The proxy statement is attached as an exhibit to plaintiffs' original complaint and it is a part of the record in these proceedings.

The controlling issue of fact raised by Count II of the Complaint and defendants' answer thereto may be stated as follows: As a matter of law, did the proxy statement disclose to the shareholders of Auto-Lite all of the material facts with respect to the control of the Board of Directors of Auto-Lite by Mergenthaler and American Manufacturing so that the shareholders could bring their own independent judgment to bear on the directors' endorsement of the merger proposal?

I find that the proxy statement does not conform to the disclosure requirements of Section 14(a) and Section 29 of the Securities Exchange Act of 1934. As stated by the Seventh Circuit in *Borak* v. *J. I. Case,* 317 F. 2d 838 (1963) at page 848:

> "The obvious purpose of Section 14(a) is the protection of the right of shareholders to a full and fair disclosure of all material facts which would affect corporate elections by proxy."

A perusal of the proxy statement establishes beyond question that it contained material omissions and partial disclosures which would mislead the shareholders of Auto-Lite.

The defendants admit that they are responsible for the proxy statement of May 29, 1963 (Answer, Count II, par. 4). They admit the authenticity of the proxy statement attached as an exhibit to the plaintiffs' original complaint (Answer, Count II, par. 6).

At Page 2 of the proxy statement, there appears the following recital:

> "The Board of Directors has carefully considered and approved the terms of the merger and recommends that the shareholders vote to approve the plan of merger.
>
> "After a thorough review of all factors involved, both Boards of Directors are of the opinion that the merger would be mutually beneficial to the Constituent Corporations and their respective shareholders."

The failure of the proxy statement to disclose, in this context, that members of the Board of Directors of Auto-Lite were nominees of Mergenthaler is a material omission.

The defendants admit that they represented that both Boards of Directors are of the opinion that the merger would be mutually beneficial to the constituent corporations and their respective shareholders. (Complaint, Count II, Par. 6); (Answer, Count II, Par. 6).

The defendants admit that the proxy statement did not disclose that on the date of November 2, 1962, in order to secure exemption from the Investment Company

Act of 1940, the defendants stated for the record before the Securities and Exchange Commission that "it (American Manufacturing) continues to control the operations of Mergenthaler and Electric Auto-Lite" with seven of the eleven directors of Auto-Lite nominated by Mergenthaler and four held over as a matter of sufferance "in the best interests" of Mergenthaler (Answer, Count II, Par. 6). The defendants further admit that (Answer, Count II, Par. 2) "as of June 27, 1963, and since March 28, 1962, Mergenthaler controlled Auto-Lite in the sense that it was able to cause to be nominated and elected a majority of Auto-Lite's Board of Directors." The defendants also admit (Answer, Count II, Par. 2) that defendant American Manufacturing controlled Mergenthaler in the same fashion. Thus, the defendants admit that at all critical dates they continued to control Auto-Lite through their control of the Auto-Lite board.

In their answer, American Manufacturing and Mergenthaler advance no affirmative defenses by way of additional facts that in any way detract from their admissions of responsibility for nondisclosure of their relationship to the Auto-Lite Board of Directors.

The parties are not in agreement on all matters. Thus, the defendants (Answer, Count II, Par. 6) deny plaintiffs' allegation that the shareholders of Auto-Lite relied on the misrepresentations and nondisclosures of the proxy statement. This denial does not raise an issue of fact crucial to the plaintiffs' motion for summary judgment, for the reason that the issue of reliance of individual shareholders is not material to the right to relief from a merger based on invalid proxies.

Section 14(a) of the Securities Exchange Act of 1934 authorizes the Commission to issue regulations governing proxies and Regulation 14a-9 provides that there shall be "No solicitation" by a proxy statement that is "false or misleading with respect to any material fact" either by positive statement or by omission. The Regulation

does not refer to any element of reliance and it conspicuously avoids any use of the common law terms of "fraud" or "deceit" that might import the element of reliance.

To attach to such auxiliary private enforcement proceedings any requirement of proof of individual reliance would be inconsistent with the function of the regulatory statute and would largely destroy the effectiveness of the private enforcement remedy. Cf. *Esten* v. *United States*, 223 F.2d 19, 22 (C.A. 5, 1955).

As the Supreme Court pointed out in the *Borak* opinion, "The injury which a stockholder suffers from corporate action pursuant to a deceptive proxy solicitation ordinarily flows from the damage done the corporation, rather than from the damage inflicted directly upon the stockholder. The damage suffered results not from the deceit practiced on him alone, but rather from the deceit practiced on the stockholders as a group . . ."

To require proof of individual reliance would be contrary to the mandate of the Seventh Circuit as expressed in the *Borak* decision. As the Court observed at page 435, "Furthermore, the hurdles that the victim might face (such as separate suits, as contemplated by *Dann* v. *Studebaker-Packard Corp.* supra . . .) might well prove insuperable to effective relief."

The defendants have filed numerous affidavits in order to establish that members of the Auto-Lite board are men of honor and "independent judgment". This assertion is also found in Defendants' Answer, Count II, Par. 2.

I find it unnecessary to consider this contention since it is irrelevant to the issue before me. What is at stake is the right of the shareholders of Auto-Lite to be informed of the interrelationship between the Auto-Lite board and the defendants Mergenthaler and American Manufacturing. With knowledge of that interrelationship, the shareholders then could have brought their own informed and independent judgment to the question of how much weight

to give to the Auto-Lite board's endorsement of a merger proposal.

The following appears in 15 Fletcher Cyclopedia Corporation (Perm. Ed., 1961), at Section 7158, Pages 257-8:

> "Mergers and consolidations, which are authorized by statute in all states, usually upon the approval of two-thirds of the shareholders, can be utilized by the majority to transform the original corporation into a new one in which the rights of the minority are diminished."

Equitable remedies are available to the minority shareholders who seek to prevent being frozen out of the corporation. In the comment in 74 Harvard Law Review (1961), the following appears under the sub-heading "Equitable Remedies" at Pages 1636 and 1640:

> "Most courts agree that the majority owes some duty to the minority shareholders, and many term it 'fiduciary' . . . .
>
> "Mergers and other structural changes are especially drastic and damaging to the interests of the minority shareholder, since they change fundamentally or even extinguish the corporate entity in which he orignally invested. Furthermore, these are *not* everyday business decisions presumptively within the discretion of the board of directors."

In *Borak* v. *J. I. Case Company,* 317 F.2d 838 (7th Cir. 1963), the Court of Appeals for the Seventh Circuit stated at Page 848:

> "Section 14(a) prohibits the solicitation of proxies of securities listed on a national exchange in violation of SEC Rules promulgated thereunder. Rule 14a-9 prohibits the use of false and misleading statements with respect to any material fact or the omission of material facts which would render any statement contained in a proxy solicitation false or misleading. 17 CFR 240. 14a-9.

"Section 27 of the Act vests exclusive jurisdiction in the United States District Courts over violation of the Act or SEC Rules and over all suits in equity or actions at law brought to enforce any liability or duty created by the Act or SEC Rules.

"The obvious purpose of Section 14(a) is the protection of the right of shareholders to a full and fair disclosure of all material facts which affect corporate elections by proxy. *Dann* v. *Studebaker-Packard Corp.*, (6 Cir., 288 F. 2d 201), at 208. See also *SEC* v. *Transamerica Corp.*, 3 Cir., 163 F. 2d 511, 518, cert. denied 332 U.S. 847. For the achievement of that purpose, the jurisdiction conferred by Section 27 must be broad enough to effectively protect that right. Thus, it is said in *Bell* v. *Hood*, 327 U.S. 678, 684, that federal courts have the power, under a general grant of jurisdiction to enforce a federal statute, to grant all of the relief which may be commensurate with the effective enforcement of the statute and the protection of rights created thereby, notwithstanding the failure of the statute to specify the remedies which may be employed.

"Indeed, Section 27 has many times been so construed in cases arising under Section 10(b), the courts holding that the jurisdictional grant includes the power to award damages and other restrospective relief . . . .

"In *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282, the Court, applying the provisions of the Securities Act of 1933, which were similar to the provisions of Section 27, held that purchasers of securities sold in violation of the Act had a civil cause of action, not only against the vendor of the securities and other persons specified in Section 12(a) of the Act, but also against a third person having assets of the vendor in its possession. The court said, in part, 311 U.S. at 288: 'the power *to enforce* implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or

actions normally available to the litigant according to the exigencies of the particular case * * *.'

"We think the same principle must be applied in determining the scope of federal jurisdiction for the protection of rights created by Section 14(a). We hold that the court below has jurisdiction under Section 27 to award damages or such other retrospective relief to the plaintiff as the merits of the controversy may require."

In holding that a private action could be based upon a violation of Section 14(a), the Court of Appeals followed the position favored by Professor Louis Loss in his authorative treatise. (Loss, 2 Securities Regulation (2nd Ed., 1961) Pages 943-946).

In *Borak* v. *J. I. Case,* 377 U.S. 426 (1964), the Supreme Court stated at Page 432 that "Private enforcement of the proxy rules provides a necessary supplement to Commission action." The Court further held at Page 434 that the appropriate remedy to provide the needed supplement was not to be limited to "prospective relief" but was to embrace "all necessary remedial relief."

I have determined that plaintiffs' motion for summary judgment on Count II of the amended and supplemental complaint is well founded. Material facts concerning the contents of the proxy statement are not in dispute. Omissions and partial disclosures in the proxy statement do not conform to the requirements of Rule 14(a). The usual remedy in such a case is to set aside a merger based upon invalid proxies, and the plaintiffs seek this remedy. I am, however, cognizant of the fact that this derivative action is brought in equity. Substantial questions are yet to be resolved: (1) What is the extent of financial injury to the minority stockholders of Auto-Lite? (2) Must I set aside the merger as an inevitable consequence of my finding that there has been a violation of the disclosure requirements of the Securities Act? (3) What effect will a newly contemplated merger have upon disentanglement of the Auto-Lite—Mergenthaler merger? These three ques-

tions are to be briefed by the parties simultaneously and submitted to me not later than Wednesday, November 24, 1965. I do not intend to have oral arguments at that time. However, I shall study your briefs concerning appropriate remedial action. If relief requires a disentanglement of this merger and a reinstatement of the Corporate Charter of Auto-Lite or other appropriate relief, I shall appoint an impartial third person to act as a Commissioner to facilitate remedial action.

My ruling in this matter shall be subject to revision and supplemental orders. Until such time as I have decided upon appropriate relief, this shall not be considered a final order within the meaning of Rule 54(b) of the Federal Rules of Civil Procedure.

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In the
Supreme Court of the United States

OCTOBER TERM, 1968

No. 1133

ELMER E. MILLS and LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

To the Honorable, The Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Respondents pray that the petition for writ of certiorari be denied.

QUESTIONS PRESENTED

The four questions listed by petitioners are founded upon a distortion of the opinion of the Court of Appeals. There is but one question presented:

Was the Court of Appeals correct in reversing an interlocutory summary judgment as to liability and remanding the case for trial with the burden placed upon the defendants on the issue of causal relationship?

STATEMENT OF THE CASE

Petitioners' statement of the case is inadequate and misleading. Contrary to their assertion, the Court of Appeals did not deny them a federal remedy, but merely reversed an interlocutory and partial summary judgment order and remanded the matter for trial. An accurate description of the proceedings below is a complete answer to the petition.

Petitioners, plaintiffs below, attack and seek to invalidate the 1963 merger of The Electric Auto-Lite Company ("Auto-Lite") with Mergenthaler Linotype Company ("Mergenthaler").

Prior to the merger, each Auto-Lite shareholder received a 108 page proxy statement containing extensive financial and other business data concerning both Auto-Lite and Mergenthaler. The proxy statement also contained the independent opinion of Standard Research Consultants that the merger terms were fair to the Auto-Lite shareholders.

The proxy statement set forth that Mergenthaler owned 54% of the outstanding Auto-Lite stock, that American Manufacturing Company ("American") and its president, Mr. Wattles, owned 33.41% of the outstanding Mergenthaler stock, and that no other person owned more than 10% of the stock of either Mergenthaler or Auto-Lite. It also stated that Mergenthaler intended to vote its stock in favor of the merger. The proxy statement did not refer to an earlier proceeding before the SEC in which American

obtained an exemption from the Investment Company Act of 1940. During the course of those proceedings, American had stated that the directors of Auto-Lite were nominees of Mergenthaler.

Petitioners' complaint attacking the merger is divided into three counts. The District Court granted petitioners' motion for partial summary judgment as to one count only, Count II. That count charges that the sole purpose of the merger was to effectuate a "fraudulent plan" to take over Auto-Lite's business at a loss to Auto-Lite of over $31,000,000.00. Count II further charges that no Auto-Lite director was independent and free from the control and domination of Mergenthaler and that the proxy statement concealed that fact. Petitioners seek damages allegedly resulting from the merger and to void the merger.[1]

In May, 1965, petitioners moved for summary judgment as to a portion of the claim set forth in Count II on the ground that the proxy statement had failed to disclose the "controlling" relationships between Auto-Lite, Mergenthaler and American. This motion was granted on November 15, 1965.

On February 14, 1966, the District Court rendered a supplemental opinion holding that its November 15, 1965 opinion was not a summary judgment ruling, but merely a "specification of facts appearing without controversy" pursuant to Rule 56(d). The Court further held, pursuant to the mandate of *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), that it was required to determine whether there was

[1] Petitioners claim that the merger terms were grossly unfair. However, the value of the investment of the Auto-Lite shareholders who converted their preferred stock in the merged company to common has more than doubled since the merger.

a "causal connection" between the deficiency in the proxy statement and the merger.[2]

Petitioners thereafter filed a motion for "supplemental" summary judgment asserting that a causal relationship had been established since some of the votes obtained through the proxy solicitation were necessary to achieve the two-thirds majority required for approval of the merger. Again, petitioners' motion was addressed only to the claim of an alleged omission from the proxy statement and not to the charge that respondents participated in a "fraudulent scheme."

In opposition to this motion respondents submitted affidavits of each Auto-Lite director stating that he was not dominated by Mergenthaler and that he exercised independent judgment in analyzing and approving the merger. The Standard Research opinion as to the merger terms was filed with the Court, as was the current opinion of a leading securities analyst who stated that the merger ratio was fair to the Auto-Lite shareholders. Other affidavits were also filed, including that of an independent accounting firm to the effect that the financial statements in the proxy statement fairly reflected the results of the operations of Auto-Lite and Mergenthaler in accordance with SEC regulations.

On September 26, 1967, the District Court *sua sponte* injected antitrust criteria into the case in an attempt to resolve the issue of causal relationship. The Court ruled that

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[2] This opinion, omitted from the petition, is attached as an appendix. Following the limited hearing held pursuant to this order at which petitioners testified that they were not misled by the proxy statement, the Court set the matter for trial on the ground that it was required to view the entire merger transaction in order to decide the case. (Hearing, June 16, 1966, Tr. 31-32.)

"causal connection" had been established because the merger was "conglomerate" and "inherently dangerous to a healthy economy." (Pet. App. 21a.) This antitrust theory was not pleaded or argued, nor was it supported by any proof. Petitioners in effect abandoned this antitrust theory on appeal.

Although the District Court granted petitioners' motion for partial summary judgment as to liability, it refused to hold that the merger was necessarily void. Petitioners filed a cross-appeal on this issue.

The Court of Appeals agreed with the District Court that the proxy statement failed to bring out adequately the relationship between the Auto-Lite board members and Mergenthaler. The Court noted that the proxy statement contained information which would indicate, at least to those aware of the corporate process, that Mergenthaler had the power to select a majority, if not all, of the Auto-Lite board members. (Pet. App. 6a.) The Court concluded, however, that Mergenthaler's controlling 54% stock interest in Auto-Lite was not given "similar emphasis" as was the board's recommendation that the shareholders approve the merger. (Pet. App. 8a-9a.)

The Court of Appeals reversed the summary judgment order on the ground that an issue of fact existed as to the causal relationship between the deficiency in the proxy statement and the merger. (Pet. App. 10a.) The Court placed the burden upon respondents to show at trial that the merger would have been approved even if the proxy statement had not been deficient in the respect found. (Pet. App. 11a.)

The Court of Appeals did not rule on petitioners' contention that the merger was void since, under its holding, that issue was premature. (Pet. App. 12a.)

REASONS FOR DENYING THE WRIT

The petition should be denied for three basic reasons:

1. No Final Judgment Is Involved.

Petitioners have not been "denied a remedy"; the case has been remanded for trial and respondents, defendants below, have been given the burden of proving the lack of causal relationship. The petition is premature since the parties may seek review upon a full record after all issues have been resolved at trial.

2. The Court Of Appeals Was Correct In Remanding The Case For Trial.

Given the complex factual setting of this case, the Court of Appeals properly held that summary judgment was inappropriate. It correctly determined that the questions of causal relationship and damages presented by the facts of this case require a trial on the merits.

3. There Is No Conflict Among The Circuits.

"Causal relationship" has uniformly been held to be an issue best resolved in the factual setting of the entire case. The Court of Appeals followed this Court's ruling in *Borak* in determining that ". . . the causal relationship of the proxy material and the merger are questions of fact to be resolved at trial."

I.

This Court Should Not Review An Interlocutory Ruling Reversing A Partial Summary Judgment Order.

Petitioners claim to have been "denied a remedy." (Pet. 2, 8.) They further claim that the Court of Appeals has superimposed common law standards upon claims under the Securities Exchange Act. (Pet. 8-9.) These contentions are not valid and result from a distortion of the decision of the Court below.

Far from denying petitioners a remedy, the Court of Appeals has remanded this case for trial and has placed the burden upon respondents to rebut the inference that the deficiency in the proxy statement had an effect on the vote approving the merger. At trial, respondents must show that the merger would have received a favorable vote even if the proxy statement had not been deficient in the respect found.

Because petitioners *are* afforded a remedy is precisely why this Court should not review the decision of the lower court at this time. This Court does not ordinarily grant certiorari to review non-final judgments. *Cobbledick* v. *United States,* 309 U.S. 323, 324-25 (1940); *American Constr. Co.* v. *Jacksonville, Tampa & Key West Ry.,* 148 U.S. 372, 384 (1893). Lack of finality alone is sufficient reason for denying certiorari. *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.,* 240 U.S. 251, 258 (1916).

This Court recently denied certiorari in *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.,* 389 U.S. 327, 328 (1967) in the following language:

> "Petitioners seek certiorari to review the adverse rulings made by the Court of Appeals. However, because the Court of Appeals remanded the case, it is not yet ripe for review by this Court. . . . (Citing *Hamilton-Brown Shoe Co., supra.*)"

An order denying a motion for summary judgment is not appealable. *Switzerland Cheese Ass'n, Inc.* v. *Horne's Market, Inc.*, 385 U.S. 23, 24-25 (1966). Since the effect of the holding of the Court of Appeals was to deny petitioners' motion for partial summary judgment, this Court should not review this case at this time.

Review of the Court of Appeals' decision at this point will not expedite this case. Even if petitioners prevail, the trial court must still resolve questions of damages and appropriate relief which will require extensive hearings. This Court can best review a decision if it has before it a complete record, containing all findings and conclusions, all rulings, and the final judgment of the Court below. Review by this Court is more properly made upon a complete record, rather than in a piecemeal fashion.

It is particularly inappropriate for this Court to review complicated litigation at the summary judgment stage. This Court warned in *Kennedy* v. *Silas Mason Co.*, 334 U.S. 249, 256-57 (1948):

> "... [S]ummary procedures, however salutory where issues are clear-cut and simple, present a treacherous record for deciding issues of far-flung import, on which this Court should draw inferences with caution from complicated courses of legislation, contracting and practice."

II.

The Holding Of The Court Of Appeals On The Issue Of Causality Is Correct.

Contrary to petitioners' assertion (Pet. 10), the Court below followed this Court's decision in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 431 (1964):

> "In addition, some of the petitioners argue that the merger can be dissolved only if it was fraudulent or non-beneficial, issues upon which the proxy material

> would not bear. But the causal relationship of the proxy material and the merger are questions of fact to be resolved at trial, not here."

Both the trial and reviewing court in this case agreed that causality is indispensible to a claim asserted under the Securities Exchange Act. The Court of Appeals merely differed with the lower court in its definition of causal relationship and rejected, without discussion, the "anti-trust" theory advanced by the District Court and abandoned by petitioners on appeal. It also rejected petitioners' assertion that causality could be conclusively established by a mechanical showing of no more than that some proxies obtained through the solicitation were needed for approval of the merger.

The Court of Appeals held, in effect, that petitioners had established a prima facie case, but ruled that defendants should have an opportunity to show, by a preponderance of the probabilities, that the affirmative votes would have been obtained even if the proxy statement had not been deficient in the respect found.

Petitioners distort the opinion of the Court of Appeals when they state that it created a "conclusive presumption" that no shareholder will vote against a fair merger. (Pet. 6, 12, 15.) It is difficult to perceive how petitioners draw this conclusion when the opinion of the Court of Appeals specifically places the burden upon defendants to show that the deficiency in the proxy statement did not cause the favorable vote on the merger. Further, the Court did not hold that fairness alone is dispositive of the issue of causal relationship. It merely ruled that fairness "does bear" upon the causation issue. (Pet. App. 11a.)

Petitioners further misstate the proceedings below when they assert that the opinion of the Court of Appeals rests upon "common law fraud." (Pet. 6, 9, 11.) Far from

relying upon "common law" standards, the Court of Appeals applied strict standards under the Securities Exchange Act in holding that the proxy statement was deficient. If the opinion of the Court of Appeals is novel in any respect, the novelty is found in the Court's holding that a proxy statement is insufficient, not because it does not disclose all of the pertinent facts, but because certain facts are given more emphasis than others. The Court did not "skirt" or "thwart" the federal requirements of full disclosure, but applied standards far stricter than those imposed by the common law.[3]

The decision of the Court of Appeals to remand this case for trial does not erect an insuperable barrier to relief as petitioners urge. In considering the entire merger transaction, including its fairness, the trial court is directed to fashion appropriate relief, if any, in light of all the circumstances. This is hardly a novel approach to complicated equity cases.

Petitioners' argument that an inquiry into the issue of fairness will spell the death-knell of all class and derivative suits is preposterous. Any court must inquire into this issue at least in fashioning appropriate relief. If petitioners are not in fact "in a position to undertake a full-dress trial to determine the fairness of [the] merger" (Pet. 18), it is difficult to perceive how the trial

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[3] If this Court were to grant certiorari, it would be necessary to determine as a threshold question the correctness of the ruling below that the proxy statement was deficient because of its failure to emphasize to a greater degree the relationship between Auto-Lite and Mergenthaler. No other deficiency has been found to exist in the 108 page proxy statement. Review of this issue, along with the other issues in this case, should properly await a full development of the facts at trial and a final judgment.

court would proceed to fashion relief in the event it determines that respondents are ultimately liable in this litigation.

Petitioners erroneously contend that the Court of Appeals assumed "that dissolution is the only proper remedy for a consummated merger, and that dissolution is too harsh a remedy for the wrong." (Pet. 20.)[4] Nowhere in the opinion of the Court of Appeals can there be found a holding that dissolution is the only remedy for a consummated merger. The Court stated that nothing in the Securities Exchange Act required the setting aside of a consummated corporate transaction, but the Court further held that the issue of dissolution was not properly presented until the completion of a trial on the merits. (Pet. App. 11a-12a.)

It is apparently petitioners' position that they are entitled to a judgment setting aside the merger without ever making a factual showing of damages or that the merger was in any way unfair; they claim that any other result would eliminate small shareholder actions. (Pet. 19.) Petitioners would have courts invalidate all corporate transactions where proxy materials are deficient in some respect upon the bare-bone allegations of a complaint. The securities laws are not designed to reach such an extreme result, and the Court below correctly determined that a finding of causality, based upon all the facts as developed at trial, is the only way to effectuate the policies underlying the securities laws. The Court of Appeals properly rejected petitioners' *per se* theory that liability must follow no matter what the circumstances.

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[4] Petitioners' statement (Pet. 20) that this issue was "untendered" is surprising since petitioners filed a cross-appeal raising this exact issue.

Complex securities cases cannot be likened to personal injury actions where the issues of liability and damages are ordinarily independent of one another. It is settled that cases raising complicated factual and legal issues are usually not suitable for summary judgment motions on the part of plaintiffs or defendants. By directing that causal relationship and damages be determined in light of the entire merger transaction, the Court of Appeals did not establish any new or far-reaching precedent adverse to claims made under the Securities Exchange Act. Issues such as fairness and damages clearly must be inquired into by the trial court in disposing of this matter. Petitioners, who instituted this action, have in no way been prejudiced by the mandate of the Court of Appeals that this case proceed to trial on the matters raised in the complaint.

Petitioners' reliance upon *Securities and Exchange Commission* v. *National Securities, Inc.*, 89 S. Ct. 564 (1969), is misplaced. (Pet. 10, 12, 19.) In that case, this Court decided that the McCarran-Ferguson Act does not bar a suit under the Securities Exchange Act attacking an insurance company merger, and that a merger constitutes a sale within the meaning of Section 10(b) of the Securities Exchange Act. That case is in no way inconsistent with the opinion of the Court below. In *National Securities*, this Court remanded the case for trial, precisely what the Court of Appeals did here.

Petitioners' suggestion (Pet. 10) that the Court of Appeals would have decided this case differently had its decision not preceded the opinion in *National Securities* is erroneous. The decision in *National Securities* on the Section 10(b) issue was fully anticipated by the Court of Appeals for the Seventh Circuit. *Dasho* v. *Susquehanna Corp.*, 380 F.2d 262, 269 (1967).

Unlike the lower court's decision in *National Securities,* petitioners have not been held to be without a remedy under federal law. The Court of Appeals here merely held, following this Court's opinion in *Borak,* that petitioners' relief, if any, would have to await a factual resolution of the issue of causal relationship at trial.

III.

There Is No Conflict Among The Circuits.

All cases subsequent to *Borak* hold, consistent with that ruling and the ruling of the Court below, that causal relationship, unless totally lacking on the basis of the facts pleaded, must be resolved at trial. In *Miller* v. *Steinbach,* 268 F.Supp. 255, 274 (S.D.N.Y. 1967) and *Eagle* v. *Horvath,* 241 F. Supp. 341 (S.D.N.Y. 1965), the issue of "causal relationship" was held to raise triable issues of fact. Causality was referred to in *Eagle* as a " . . . material, factual question to be resolved at trial. It is not a question that can properly be adjudicated on this motion for summary judgment." (241 F. Supp. at 344.)

A case principally relied upon by petitioners (Pet. 11, 12, 14), *Laurenzano* v. *Einbender,* 264 F. Supp. 356 (E.D. N.Y. 1966), held only that a *defendant's motion to dismiss* would not be sustained where the court was unable to conclude that the proxy material was "functionless in the consummation of the transactions." (264 F. Supp. at 361-62.) In sustaining the complaint, the court noted that the ultimate resolution of the case depended upon the facts disclosed at trial and that it might develop that "the proxy solicitation was in fact of no significance." (264 F. Supp. at 362.) *Laurenzano* is in no way inconsistent with the holding in the instant case that the issue of causal relationship must be resolved following a trial on the merits.

Contrary to petitioners' assertion (Pet. 16), *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F.2d 357 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968), is not "in square conflict" with the decision below. That case related to neither a proxy statement nor a merger. No issue of causal relationship was involved. Rather, the court had before it a bond sale effected by an unregistered dealer of securities with respect to a single customer. The considerations are totally different where a court is requested to void a merger consummated almost six years ago involving thousands of shareholders. Indeed, the Court in *Eastside* expressly limited its holding to two-party transactions. (391 F.2d at 363.)

The cases which have considered the problem of "fairness" in securities litigation have rejected the idea of *per se* liability. In *Robbins* v. *Banner Industries, Inc.*, 66-67 CCH Sec. L. Rptr. ¶91,861, pp. 95,952-53 (S.D.N.Y. 1966), the court noted, "There is no insurer liability under section 14(a)." In *Cohen* v. *Colvin*, 266 F. Supp. 677, 685 (S.D.N.Y. 1967), the court denied relief where the corporation was in no way harmed by the corporate action taken.

The decision of the Court of Appeals does not establish sweeping guidelines which will affect future securities litigation or "a broad range of cases arising . . . under other federal regulatory statutes requiring full disclosure and fair voting." (Pet. 8.) It concerns the wording of a single proxy statement within the factual context of a particular merger. The Court below made a forthright attempt to deal with the complex questions raised by the unique procedural posture of the case. In remanding the case, the Court of Appeals has done nothing more than

direct the trial court to view the entire factual context of the merger in a trial setting and fashion relief, if appropriate, in conformity with the policy of the securities laws and the dictates of a court of equity.

CONCLUSION

For the above reasons, the petition should be denied so that the case may return to the District Court and proceed to a trial on the matters raised in the complaint.

Respectfully submitted,

ALBERT E. JENNER, JR.
JEROLD S. SOLOVY
Attorneys for Respondents, Eltra Corporation (previously known as Mergenthaler Linotype Company with and into which The Electric Auto-Lite Company was merged), The Electric Auto-Lite Company (now merged into Eltra Corporation), and American Manufacturing Company, Inc.

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April 4, 1969

APPENDIX

OPINION OF DISTRICT COURT

Memorandum Opinion and Order, dated February 14, 1966:

This matter comes before me for ruling on defendants' motion to vacate orders entered on November 15, 1965, and November 29, 1965. In the alternative, defendants seek to have those orders amended pursuant to the provisions of Title 28, § 1292(b), U.S.C., so that an appeal may be perfected.

The following action has been taken in this case to date: On November 15, 1965, I determined that as a matter of law there had been a violation of the disclosure requirements of §14(a) of the Securities Exchange Act of 1934. The parties were notified of my finding in a memorandum opinion, which is a part of this record. On November 29, 1965, I appointed William J. Friedman, an eminent attorney, to serve as a Master, pursuant to Rule 53 of the Federal Rules of Civil Procedure.

Although I indicated to the parties in a memorandum opinion and order, which is part of the record, that the function of the Master would be to assist the Court in determining appropriate remedial action, I also advised the parties that the order of reference would be subject to supplemental rulings. The purpose of these supplemental rulings would be to set up guide lines with respect to the procedure in the Master's investigation. Subsequently, I held a conference to enable the parties to make suggestions about the specific function of the Master.

It is worthwhile to restate the issues presented and the conclusions I have drawn thus far. The threshold question was whether there had been a violation of the disclosure requirements of Rule 14(a) of the Securities Exchange Act of 1934. I determined that the failure to disclose the fact that American Manufacturing Corporation and Mergenthaler Corporation controlled the management of Electric Auto-Lite Company, as determined by the Securities Exchange Commission, constituted the omission of a material fact from the proxy statement.

With respect to the controversy before me, it is clear that I have jurisdiction to provide appropriate relief for violation of the disclosure requirements of §14(a) of the Securities Exchange Act of 1934. As stated by the Seventh Circuit in *Borak* v. *J. I. Case,* 317 F.2d 838, 848, (1963):

> "• • • The obvious purpose of §14(a) is the protection of the right of shareholders to a full and fair disclosure of all material facts which would affect corporate elections by proxy. • • • And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case."

The opinion of the Seventh Circuit was buttressed by the opinion of the Supreme Court. In *Borak* v. *J. I. Case,* 377 U.S. 426, 432 (1964), the Court stated:

> "• • • The appropriate remedy to provide the needed supplement (to Commission Action) is not to be limited to prospective relief but is to embrace all necessary remedial relief."

A rereading of the *Borak* opinion, and of briefs submitted by counsel at my request, indicates to me that I must determine whether there was a causal connection between the finding that there has been a violation of the disclosure requirements of §14(a) and the alleged injury to the plaintiffs before I or a Master may look into the question of appropriate remedial action.

As the Supreme Court stated in the *Borak* opinion (*Ibid.*, at p. 431: "* * * But the causal relationship of the proxy material and the merger are questions of fact to be resolved at trial."

Subsequent to the *Borak* decision, a number of authorities reassert the need for an inquiry on the issue of causal connection. *Barnett* v. *Anaconda*, 238 F. Supp. 766 (1965); *Hoover* v. *Allen*, 241 F.Supp. 213 (1965); *Eagle* v. *Horvath*, 241 F.Supp. 341 (1965). See also: "Private Actions and the Proxy Rules: The Basis and Breadth of the Federal Remedy", 31 U. Chi. L. R. 328 (1964) and Note in 78 Harvard L. R. 296 (November 1964).

A determination of causal connection cannot be made on the basis of the evidence before me at this time, and I am convinced that the inquiry on this issue more properly should be heard by the Court rather than as part of a reference to a Master.

The action taken by this Court in the memorandum opinion and order of November 15, 1965, was a specification of facts appearing without controversy relating to Count II of the amended and supplemental complaint, pursuant to Rule 56(d) of the Federal Rules of Civil Procedure. Rule 56(d) states:

"Case Not Fully Adjudicated on Motion. If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court at the hearing of the motion, by examining the pleadings and the evidence before it and by interrogating counsel, shall if practicable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith controverted. It shall thereupon make an order specifying the facts that appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly."

In view of the foregoing, I shall commence proceedings at 11:00 A.M., on March 2, 1966, in order to hear evidence on whether there is in fact a causal connection between the violation of the disclosure requirements of Rule 14(a) and the alleged injury to the plaintiffs. My order of November 29, 1965, appointing a Master shall be held in abeyance pending resolution of the issue of causal connection. The hearing to commence on March 2, 1966, constitutes such further proceedings at this time which, in accordance with the language of the Rule above quoted, I find to be just.

Since no final order has been entered in this case, defendants' motion to vacate the Court's order of November 15, 1965, is premature. For the same reason, defendants' motion that I amend my orders pursuant to the provisions of Title 28, §1292(b) must be denied. *Biggins* v. *Oltmer Iron Works,* 154 F.2d 214 (7 Cir. 1946); *Commonwealth Insurance Co. of New York* v. *O. Henry Tent & Awning Co.,* 256 F.2d 200 (7 Cir. 1959).

It Is So Ordered.

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In the

Supreme Court of the United States

OCTOBER TERM, 1968

ELMER E. MILLS AND LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTOLITE COMPANY
MERGENTHALER LINOTYPE COMPANY and
AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1968

No. 1133

ELMER E. MILLS AND LOUIS SUSMAN,
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Respondents.

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1. Respondents concede (Br. p. 9) that a controlling question of law is presented: whether under *Borak* liability turns upon a finding of causal relationship between the unlawful "proxy material and the merger",[1] on the one hand, or upon a finding that the specific misleading omissions actually produced the favorable shareholder vote, on the other. That question should be reviewed now because it is "fundamental to the further conduct of the case." *United States* v. *General Motors Corp.*, 323 U. S. 373, 377 (1945); *Land* v. *Dollar*, 330 U. S. 731, 734 n.2 (1947); *Larson* v. *Domestic & Foreign Commerce Corp.*, 337 U. S. 682, 685 n.3 (1949).

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[1] *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 431 (1964).

If, as petitioners submit, *Borak* envisions only the former causal relationship, established by undisputed facts below (Pet. pp. 25a-26a), then litigation of the latter issue places a heavy and unwarranted burden on vindication of shareholder rights and defeats "the overall purposes of federal . . . policy." *Glover* v. *St. Louis-San Francisco R.R.*, 393 U. S. 324, 330 (1969). Petitioners now "must face further proceedings" on liability which, if they read *Borak* correctly, the courts below "have no power to conduct." *Construction Laborers* v. *Curry*, 371 U. S. 542, 550 (1963).

2. By transforming the question of causation into an issue of reliance, and converting reliance into a question of fairness of the financial terms of merger, the court below has sanctioned a defense to a violation which is unsupported by any authority. Since the preparation of the Petition, this defense of fairness has been specifically rejected by another court. In *Gerstle* v. *Gamble-Skogmo, Inc.*, ... F. Supp. ....., CCH Fed. Sec. L. Rep. ¶92,367 (E.D.N.Y., March 7, 1969), the court said (pp. 97,749-97,750):

> "Assuming, *arguendo*, there was a failure to disclose a material fact in the proxy statement, defendant claims that since the plan of merger was fair the plaintiffs suffered no damages. . . . When a seller is induced to sell his property by means of a statement which he subsequently learns is false, the fact that the sales price was fair at the time is irrelevant. The seller may thereafter maintain an action in equity for a rescission of the contract and an accounting of the proceeds and the ensuing profits. If the property cannot be returned, the plaintiff is entitled to restitution. *Falk* v. *Hoffman*, 233 N. Y. 199, 135 N. E. 243 (1922). *Janigan* v. *Taylor*, supra [344 F.2d 781 (1st. Cir. 1965), cert. denied 382 U. S. 879 (1965)] and *Kardon* v. *National Gypsum Co.*, 73 F. Supp.

798, *modified* 83 F. Supp. 613 (E.D.Pa. 1947), decided under §10(b), have both held that damage at the time of the sale of the stock is not an element of the cause of action if there has been a violation of the disclosure requirement. In this case the stockholders were defrauded by voting for a merger without vital information withheld by insiders. * * * The purpose of §14(a) was to prevent such frustration of stockholders. (H. R. Rep. No. 1383, 73d Cong., 2d Sess. 13, 14). The exercise of this right cannot be defeated by the mere promulgation of a fair plan in a merger proceeding."[2]

Beyond this added conflict among the lower courts, certiorari is required because "these rulings by the Court of Appeals [interposing new defenses] threaten the effectiveness of the private action as a vital means for enforcing the . . . policy of the United States . . . ." *Perma Life Mufflers* v. *International Parts,* 392 U. S. 134, 136 (1968).

3. Respondents seek to belittle the importance of this case (Br. p. 14) by ignoring the holding of both courts below that they were guilty of a *material* violation of §14(a), and that the proxy statement unlawfully omitted facts to which "a *reasonable* man would attach importance . . . in determining his choice of action in the transaction" and "which in reasonable and objective contemplation * * * may affect the desire of investors to buy, sell, or hold the company's securities." *SEC* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833, 849 (2 Cir. 1968). By super-adding the requirement of unfairness, and holding that corporate promoters have done no wrong, by resorting to fraud hav-

[2] Contrary to respondents' contention (Br., p. 3, fn. 1), violations of Section 10(b) and 14(a) are neither created nor destroyed by fluctuations in the Dow-Jones averages.

ing intended, reasonable, and probable effects on the mind of the investor, unless it is also found as a fact that the investor's mind was actually changed, the court below has potentially immunized every violation of any federal law requiring full disclosure for the protection of the public.[3]

4. Respondents' repeated assertion that "Petitioners have not been 'denied a remedy'" (Br., pp. 6, 7, 13, 15), is in flat contradiction to the Court of Appeals' direct holding. The District Court had held that liability was established, and that petitioners were entitled to a remedy to be fashioned. The Court of Appeals did not affirm but reversed, holding that petitioners were entitled to no remedy, and would be entitled to none without a finding that "the misleading statement and omission caused the submission of sufficient proxies"; the fairness of the merger, in its financial terms, would show no "causation", and immunize the violation. (Pet. 11a). The petitioners bought stock to become part owners in an automotive parts business, and they are here asserting their federally protected right to continue that ownership until altered by corporate action in compliance with federal law. Through an admitted and adjudged violation of that law, they have been made part owners in a conglomerate, against their will. This wrong, they are told by the Court of Appeals, does not warrant relief.

5. Respondents' argument that certiorari is not available "to review non-final judgments" (Br. p. 7) is based on misconception. Section 1254 of the Judicial Code contains no such requirement, but on the contrary authorizes certiorari before or after the Court of Appeals decision.

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[3] This Court has recognized that Sections 10(b) and 14(a) apply *in pari materia* in merger cases. *SEC v. National Securities, Inc.*, 393 U. S. 453 (1969).

Authorities cited which arise under other statutes requiring a "final decision" for appellate review have no application,[4] and serve rather to emphasize the broad discretion conferred by §1254. The fact that a Court of Appeals has remanded a case for trial upon holding summary judgment improper does not, of course, prevent review in this Court. E. g., *United States* v. *Coleman*, 390 U.S. 599 (1968); *Wyandotte Trans. Co.* v. *United States*, 389 U.S. 191 (1967). Cf. *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). Having taken advantage of the procedures of §1292(b) of the Judicial Code to obtain review of "a controlling question of law" on the ground "that an immediate appeal may materially advance the ultimate termination of the litigation", respondents now shift position and argue that further review of this "controlling question" is somehow improper. Consonant with the policy of that section, this Court properly reviews decisions which the Court of Appeals had power to render, without regard to the interlocutory character of the District Court decision. See, *e.g.*, *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967) (denial of motion to dismiss complaint under securities laws); *Ross* v. *Bernhard*, ... U.S. ..... (Dkt. No. 992,

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[4] Of the four cases cited on page 7 of Respondents' Brief, *Cobbledick* and *American Construction* arose under statutes specifically requiring a "final decision" and a "final judgment," respectively. *Hamilton-Brown Shoe* involves merely the familiar proposition that the denial of certiorari does not constitute affirmance. In *Locomotive Firemen*, the petitioners had succeeded in persuading the Court of Appeals to overturn the District Court's order, and the denial of certiorari merely confirmed this Court's tradition of not granting review at the instance of the party who prevailed in the Court of Appeals.

cert. granted March 24, 1969) (striking jury demand in securities case); *Dairy Queen* v. *Wood*, 369 U.S. 469 (1962).

The opinion of the Court of Appeals itself (Pet. pp. 1a-12a) stands as sufficient refutation of respondents' repeated epithets (Br. 1, 2, 7, 9) of "distortion" and "misleading" statements in the Petition.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted so that this Court may settle the conflict among the lower courts and determine the elements of the private cause of action necessary to the enforcement of the federal policy for protection of investors.

Respectfully submitted,

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April 11, 1969

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OCTOBER TERM, 1969.

ELMER E. MILLS AND LOUIS SUSMAN,
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vs.

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Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969.

No. 64

ELMER E. MILLS AND LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

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BRIEF OF PETITIONERS ELMER E. MILLS AND LOUIS SUSMAN

OPINIONS BELOW

The November 25, 1968, opinion of the Court of Appeals for the Seventh Circuit is reported at 403 F.2d 429 (A.1001); its Order is set forth in the Appendix, page 1015. The September 26, 1967, opinion of the District Court for the Northern District of Illinois is reported at 281 F. Supp. 826 (A.675); the District Court's unreported September 26, 1967, Findings of Fact appearing

without substantial controversy and Conclusions of Law on which summary judgment was granted are set forth in the Appendix, pages 684 and 689, respectively, and its unreported September 26, 1967, Order granting Motion for Summary Judgment is set forth in the Appendix, page 690. The District Court's unreported November 15, 1965, Memorandum Opinion granting Summary Judgment as to Count II of the Amended and Supplemental Complaint is set forth in the Appendix, page 441.

JURISDICTION

The order of the Court of Appeals for the Seventh Circuit sought to be reviewed was entered on November 25, 1968. The Petition for Certiorari was granted on April 21, 1969. This Court has jurisdiction under 62 Stat. 928, 28 U.S.C. 1254(1). The case arises under the provisions of the Securities Exchange Act of 1934, as amended, 48 Stat. 881, 15 U.S.C. §78a, *et seq.*

THE STATUTES AND RULE INVOLVED

Section 14(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 48 Stat. 895,[1] provides:

[1] This section was amended August 20, 1964, 78 Stat. 569, after this action was commenced, but no changes were made which are of consequence to this action. As amended, Section 14(a) provides:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 12 of this title.

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 14a-9(a) promulgated by the Securities and Exchange Commission pursuant to Section 14(a) of the 1934 Act, 17 C.F.R. 240.14a-9(a) provides:

> No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

Section 29(b) of the 1934 Act, 48 Stat. 903, provides:

> Every contract made in violation of any provision of this title or of any rule or regulation . . . shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract . . . .

QUESTIONS PRESENTED

1. Whether minority stockholders are denied any federal remedy for material misrepresentations in a proxy statement, violative of Section 14(a) of the 1934 Act, soliciting necessary votes for a merger, if the court can be satisfied that the merger terms are fair by common law standards.

2. Whether liability for material misrepresentation in a merger proxy statement violating Section 14(a) of the 1934 Act depends upon a factual finding that a critical number of votes were changed by the particular omission or misrepresentation.

3. Whether a factual finding, if relevant, that a critical number of votes were not changed by the particular omission or misrepresentation in a merger proxy statement, excusing its violation of Section 14(a) of the 1934 Act, may be predicated upon fairness of the financial terms of merger.

4. Whether all relief for material misrepresentation in a proxy statement for a merger enjoinable under Section 14(a) of the 1934 Act is barred by consummation of the merger if the court can be satisfied that the merger terms are fair by common law standards.

STATEMENT OF THE CASE

Petitioners were shareholders of The Electric Auto-Lite Company ("Auto-Lite") until 1963, when it was purportedly acquired by and merged into Mergenthaler Linotype Company ("Mergenthaler"), which thereupon was renamed Eltra Corporation. Under the merger terms Auto-Lite stock already owned by Mergenthaler was to be retired, and thus "[i]n a real sense, the merger was a

bargain between Mergenthaler and the minority shareholders in Autolite." A.1009. "In substance, Mergenthaler was offering that . . . all minority common stock interests in Autolite would be transformed into preferred stock interests" (A.1005) in the resulting new conglomerate. The proxy statement was "in form, addressed to all shareholders, [but] was, in realistic terms, intended for the minority shareholders." A.1005. In it, the value of the minority shareholders' equity in Auto-Lite was acknowledged to be $46.7 million, while the value of the preferred stock they were to receive in return was fixed at $34.4 million, the differential of $12.3 million being assigned as capital surplus accruing to the Mergenthaler shareholders' equity as a result of the merger. A.39.

The proxy statement did *not* reveal that its ostensible authors, the Auto-Lite Directors, were all nominees of Mergenthaler, selected and deputed to serve "the best interests of Mergenthaler". A.1009. This was established by respondents themselves in proceedings under the Investment Company Act (A.237) resulting in an adjudication by the SEC in respondents' favor two months earlier. A.418. In their proxy statement, however, "[t]he Autolite board, selected by their adversary, presumed to advise the minority shareholders to approve the merger" (A.1009) and "implied that the board was giving disinterested advice." A.1010. They printed their recommendation in large bold face type (A.1006) on the second page of the complex 108 page document. A.30.

Suing for the shareholders of Auto-Lite as a class and derivatively on behalf of Auto-Lite, petitioners alleged that the proxy statement used to solicit votes in favor of the merger was materially misleading in violation of Section 14(a) of the 1934 Act and Rule 14a-9 thereunder.

Their complaint alleged that because votes essential to authorization of the merger were obtained through use of the unlawful proxy statement, the merger was void. They prayed that the merger be set aside, that the assets of Auto-Lite be returned to it, and that damages and other appropriate equitable relief be awarded. A.179-80.

The District Court and the Court of Appeals both held that "mailing the proxy statement was unlawful" under Section 14(a) of the Act (A.1011), because of its "omission of a material fact necessary in order to make the statements therein not misleading." *Id.* The District Court and the Court of Appeals both found that without the votes of the minority stockholders, obtained through the unlawful proxy solicitation, approval of the merger was not achieved. A.1011.[2]

Having made these findings, the District Court entered "summary judgment . . . on the issue of liability alone" (Fed. R. Civ. P. 56(c)), in the nature of a declaratory judgment for petitioners. A.690. "Relief was left for further consideration after hearings before a special master and a report thereon." A.1012.

The Court of Appeals held that, although the proxy statement was materially misleading, the facts did not suffice to establish the requisite causal relationship between the proxy statement and the merger, because in its view "the more exact question is whether the misleading statement and omission caused the submission of sufficient proxies." A.1013.

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[2] "[T]he merger required favorable votes representing at least two-thirds of the Autolite shares, and in order to count a two-thirds vote, one must include votes which were cast by authority of proxies obtained by the challenged solicitation." A.1011.

This formulation of the question was thought to follow from the court's premise that liability is not established unless "the unlawful act caused some inequity or damage which the court should relieve or redress." A.1011. The opinion assumed that there would be no inequity or damage to be relieved or redressed if the trial judge were satisfied of the probability that "the merger would have received a sufficient vote even if the proxy statement had not been misleading". A.1013. The Court of Appeals acknowledged that this approach corresponds to the common law fraud test, "whether the injured party relied on the misrepresentation." A.1013, n.10. It eschewed direct resolution of that question, however, on the ground that "[r]eliance by thousands of individuals, as here, can scarcely be inquired into." *Id.* It resorted, instead, to indirect resolution, predicated upon a presumption that stockholders would have voted for merger, regardless of misrepresentation, if "the merger has merit and the terms were in fact fair and equitable to the minority shareholders." A.1012. With the aid of this presumption, the court below was able to conclude: "The material offered by defendants on the merits of the terms of merger suggests that it may be possible for them to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013.

On this approach, if respondents could satisfy the court of the merit and fairness of the substantive terms, then, regardless of the material violation, "there would be no sound basis for disruption of the merger *or other relief*." A.1013 (emphasis added). The Court of Appeals' express rationale was its unwillingness "to unscramble a corporate

transaction merely because a violation occurred." A. 1013-14.

The court rejected petitioners' claim that legal injury consists of the invasion, through material misrepresentation, of the right of Auto-Lite to continue its corporate existence, and of its shareholders as a class to preserve that status, until altered through authorization obtained in accordance with law, and that merit or fairness of the substantive terms is therefore irrelevant to the issue of liability. A.1012.

Accordingly, the court reversed the adjudication of liability and remanded the cause for a trial, in effect, on the "merits of the terms of merger" (A.1013), assessing all costs of the appeal, amounting to approximately $9,000, against petitioners. A.1015.

SUMMARY OF ARGUMENT

The Court of Appeals erred in adopting a test of causation which requires a trial determination on the issue whether the misleading omission in the proxy statement changed the minds of sufficient shareholders to alter the result of the election, and compounded the error by ruling that this issue is governed by the merit and fairness of the merger in its substantive terms. The decision is in direct conflict with:

I. the express holdings of this Court in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964);

II. the congressional purpose to eliminate reliance, and causal tests derived from it, from the cause of action for breach of a disclosure statute compelling general dissemination of full and complete information to investors at large;

III. the practical limits of judicial trial processes when the issue is the effect of nondisclosure on mass mental processes;

IV. the congressional purpose to protect the shareholders' right to a free and informed vote (and conflicts as well with common experience), in presuming that shareholders would approve any fair merger;

V. the necessity for effective private remedies to supplement SEC action in the enforcement of the Act.

This Court's decision in *J. I. Case* v. *Borak* is dispositive. It held that the Securities Exchange Act of 1934 creates "a federal cause of action for rescission or damages . . . with respect to a consummated merger which was authorized pursuant to the use of a proxy statement . . . contain[ing] false and misleading statements violative of §14(a) . . . ." In direct conflict with this Court's decision, the Court of Appeals held that no cause of action is created even though the proxy solicitation made use of a proxy statement violative of the Act and produced votes essential to merger approval, unless an additional requirement of "causation" is met by a finding that the stockholders would not have approved the merger without the misleading statements and omission. This superadded element of the cause of action, effectively negating *Borak,* was derived by the Court of Appeals from the "corresponding" test of reliance in common law fraud cases. But Congress, in enacting compulsory disclosure statutes like §14(a), assumed reliance and fostered it, in the interests of public confidence in the securities market and of the prophylactic values of exposure. It thus eliminated reliance — or a test of causation derived from it — as an element of the private remedy. Thus the proper test of causation, under *Borak,* asks whether the proxy

solicitation, itself the violation, caused the merger, as it did here, not whether the particular misstatement or omission caused enough investors to change their minds to alter the outcome of the vote.

The Court of Appeals' transformation of causation into reliance inevitably entangles the court in an impracticable inquiry into the mental processes of thousands of stockholders. Confronted with this impossibility, a court can give effect to the statutory command only by accepting the congressional finding that the public will rely on documents compulsorily disseminated to investors at large, and then by taking appropriate remedial action upon the basis of the intended, reasonable, and probable tendency of the misrepresentation. A trial could add nothing.

Compounding the error, the presumption that stockholders would approve any fair merger, devised by the Court of Appeals to escape the impracticalities of direct proof of mental processes, defies common experience as a matter of fact, and destroys the right of corporate suffrage which Congress sought to protect as a matter of law. Judicial appraisal of the substantive merit of the merger cannot replace the stockholders' free and informed vote. Beyond circumventing stockholder choice, the ruling makes the statute a superfluous condemnation of unfair mergers, merely restating the common law rule of "constructive fraud," and gives the investor fewer remedies than the common law affords in cases of actual fraud or nondisclosure of conflicts of interest, in which fairness is no defense.

By inviting corporate insiders to wage a war of attrition through exhaustive litigation of the fairness of the merger — or of any other factor which might bear on the prob-

ability that the shareholder vote was unaffected — the Court of Appeals' decision will discourage private enforcement by small shareholders, not only under §14(a) but under all securities laws, and will destroy the private action as an effective weapon, and a necessary supplement to Commission action, in the enforcement of federal policy for the protection of investors.

The findings affirmed by the Court of Appeals complete the cause of action and establish liability, entitling petitioners to immediate judgment in their favor, including at least a declaratory judgment and accounting, nominal damages, counsel fees and costs, for vindicating the corporate right and enforcing the policy of the Act. In the further proceedings correctly directed by the District Court, relief through specific rescission of the merger is not foreclosed by its consummation, and may be necessary to "make effective the congressional purpose," as declared in *Borak* and *National Securities*. Alternative relief in money restitution, as a traditional remedy in securities cases, is available to compel respondents to disgorge the fruits of their proven wrong.

ARGUMENT

I. THE SEVENTH CIRCUIT'S DENIAL OF ANY LIABILITY OR REMEDY FOR A MATERIAL VIOLATION OF THE ACT CONFLICTS WITH THIS COURT'S DECISION IN J. I. CASE CO. v. BORAK

The judgment of the Court of Appeals, and the rationale of the third section of its opinion under the heading "*The causal relationship and appropriate relief*", are in direct conflict with the unanimous decision of this Court in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) (hereafter cited "*Borak*"). The explicit holdings of this Court squarely refute, by direct contradiction, every supposed reason offered by the court below to support its reversal of the District Court. In short, this Court has already decided this case, and summary reversal is called for.

A side-by-side comparison of this Court's *Borak* opinion with the third section of the Court of Appeals' opinion reveals irreconcilable conflict and frontal collision on every salient point:

1. *The necessity of relief when federally secured rights are invaded.* The whole thrust of this Court's decision in *Borak* is "'to grant the necessary relief' where federally secured rights are invaded." 377 U.S. at 433. Relief must follow upon a violation because "if the law . . . happened to attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated." 377 U.S. at 434-35. That congressional purpose, "to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy

solicitation" (377 U.S. at 431), creates "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." 377 U.S. at 433.

In the teeth of this Court's command, and in the face of its own unequivocal holding that respondents were guilty of a clear violation of the Act, the Court of Appeals concludes that this invasion of federally secured rights provides "no sound basis for disruption of the merger *or other relief*." A.1013 (emphasis added). In its view, a violation of the Act carries no consequences; a court has no duty — or power — to act without a further showing that "the unlawful act caused some [other] inequity or damage which the court should relieve or redress." A.1011. Because the Court of Appeals does "not consider that the policy of the '34 act requires the court to unscramble a corporate transaction merely because a violation occurred" (A.1013-14), it holds that no liability exists, and that *no* remedy — even declaratory — can be granted, "*merely* because a violation occurred." *Id.* (emphasis added).

To replace this Court's command in *Borak*, the Seventh Circuit thereupon announces its own rule, devised through tortuous transformation of causation into reliance, and reliance into fairness, that the violators of federal law are immune so long as the court finds "that the merger has merit and the terms were in fact fair and equitable to the minority shareholders". A.1012. The ruling is well calculated to eviscerate "[t]he purpose of §14(a) . . . to prevent management . . . from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation." 377 U.S. at 431. Virtually any corporate transaction, no matter how fraudulently

induced, may nonetheless be defensible as substantively "fair", and since the Seventh Circuit's rule would "attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated." 377 U.S. at 434-35. This Court imposed in *Borak* a judicial duty to enforce the congressional declaration that it is unlawful to obtain authorization for corporate action through inadequate or deceptive disclosure in proxy solicitation. The Court of Appeals was powerless to override that judgment, and to arrogate to itself the right to decide that in such a case there is no "inequity or damage which the court should relieve or redress." A.1011.

2. *The components of the statutory cause of action.* In *Borak* this Court held that "§27 of the Act authorizes a federal cause of action for rescission or damages to a corporate stockholder with respect to a consummated merger which was authorized pursuant to the use of a proxy statement alleged to contain false and misleading statements violative of §14(a) of the Act." 377 U.S. at 428. These component elements, as *Borak* held, complete a federal "claim upon which relief can be granted" under Rule 12(b)(6), Fed. R. Civ. P., without regard to the form of appropriate relief. The Court specifically disapproved other lower court decisions adding non-federal requisites to the cause of action, in the light of "the overriding federal law applicable here" (377 U.S. at 434), and because "the hurdles that the victim might face" if state or common law requirements were interposed "might well prove insuperable to effective relief." 377 U.S. at 435.

The Court of Appeals agreed with the District Court that this "consummated merger was authorized pursuant

to the use of a proxy statement . . . contain[ing] false and misleading statements violative of §14(a) of the Act." *Borak*, 377 U.S. at 428. With the requisite elements thus established, the District Court had properly adjudged the issue of liability, and ordered further hearings on the relief to be granted. In direct contravention of *Borak's* enumeration of the components of the statutory cause of action, the Court of Appeals reversed, holding that these elements did not establish liability, and that no remedy could be considered — and none could be granted — until a trial had been held and determination made on the further question whether the stockholders might have approved the merger if the proxy statement had not contained misleading statements.

The Seventh Circuit constructed this supposed issue by adding two extraneous requirements to the private "right under §27 to bring suit for violation of §14(a)" (377 U.S. at 430): *reliance* and *unfairness*. By importing a requirement of *reliance*, borrowed from "common law fraud" (A.1013, n. 10) and converted to a test of causation, the Court of Appeals violated *Borak's* teachings and adopted "the rejected argument that the elements of technical common-law fraud . . . must be established" in a suit to enforce the securities laws. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200 (1963). By engrafting a requirement of *unfairness* onto the statutory cause of action, the Court of Appeals again violated the *Borak* principles, as subsequently confirmed by this Court's holding that "[t]he gravamen of the complaint was the misrepresentation, not the merger", and that approval of the merger's substantive terms under state law does not affect the federal cause of action for unlawful proxy solicitation. *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 462 (1969).

3. *The causal relationship between the proxy solicitation and the merger.* In *Borak,* this Court noted that Congress' "broad remedial purposes are evidenced in the language of the section which makes it 'unlawful for any person . . . to solicit any proxy . . . in contravention of'" SEC rules. 377 U.S. at 431-32. "[T]o make effective the congressional purpose" thus delineated (377 U.S. at 433), unlawful proxy solicitation creates the judicial duty to provide a remedy. The requisite "causal relationship of the proxy material and the merger" (377 U.S. at 431) is satisfied when there is "corporate action pursuant to a deceptive proxy solicitation". 377 U.S. at 432. No more is required than that the "consummated merger . . . was authorized pursuant to the use of a proxy statement . . . contain[ing] false and misleading statements violative of §14(a) of the Act." 377 U.S. at 428.

The Court of Appeals conceded that this causal test as laid down in *Borak* had been fully met. It found unequivocally that respondents had violated federal law in failing to disclose material facts in their proxy statement, and therefore that "mailing the proxy statement was unlawful." A.1011. The Seventh Circuit also found unequivocally that the merger constituted "corporate action pursuant to a deceptive proxy solicitation" and "was authorized pursuant to the use of a proxy statement . . . violative of §14(a)" (*Borak,* 377 U.S. at 432), since the votes of the minority shareholders produced by the proxy solicitation were numerically essential to a favorable total vote.[8] The opinion is explicit: "It is clear

[8] To obtain the required two-thirds vote, respondents needed favorable proxies from approximately 27% of the minority shares. The proxy solicitation produced favorable votes from about 60%. A.687-88.

. . . that in order to count [the required] two-thirds vote, one must include votes which were cast by authority of proxies obtained by the challenged solicitation. The District Court concluded that since this is so, the proxy statement was a cause of the merger . . . ." A.1011-12.

The Seventh Circuit flatly rejects the test of causation declared in *Borak* and correctly applied by the District Court.[4] It prefers instead "the more exact question . . . whether the misleading statement and omission caused the submission of sufficient proxies." A.1013. Unsatisfied by the fact that the unlawful proxy solicitation caused the merger, and insistent upon proof of "causal relationship between the *deficiency* in the proxy statement and the merger" (A.1012), the Court of Appeals departs from reality and enters the realm of conjecture. The hard facts of the actual occurrence answer this Court's test of whether the proxy solicitation caused the merger. To answer the Seventh Circuit's test of what "might have been", the only source is conjecture and speculation about a hypothetical situation where the shareholders are deemed to have known what in fact they did not know. In this unreal world, the trier of fact is told to look back and to count how many shareholders would have changed their minds, to determine whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013. This phrasing of the question substitutes a purely metaphysical exercise for the practical and realistic factual determination directed by this Court's test.

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[4] See also *Laurenzano* v. *Einbender*, 264 F.Supp. 356, 361 (E.D.N.Y. 1966), denying dismissal for lack of causation so long as the unlawful "proxy solicitation . . . was calculatedly infused into the matrix of the transactions . . . ."

4. *The necessity for effective private enforcement after the merger is consummated.* This Court in *Borak* declared that Congress had authorized a private cause of action "with respect to a consummated merger" because "[p]rivate enforcement of the proxy rules provides a necessary supplement to Commission action" and "serves as a most effective weapon in the enforcement of the proxy requirements." 377 U.S. at 428, 432. For these reasons, the Court found no "merit in the contention that such remedies are limited to prospective relief" (377 U.S. at 434), and rejected the application of state law which might "attach no responsibility to the use of misleading proxy statements" or raise "hurdles . . . [which] might well prove insuperable to effective relief." 377 U.S. at 435.

In contrast, the Court of Appeals had "no question but that . . . corrective measures [in the form of prospective relief] would have been appropriate" on the established facts, but held that no such "corrective measures" were permissible when "the matter did not really come before the court until too late for preventive action." A.1011. In its view, consummation of the merger required use of a different standard to "determine in retrospect whether the unlawful act caused some inequity or damage which the court should relieve or redress." A.1011. The stated rationale for the different standard of liability is the reluctance of "the court to unscramble a corporate transaction merely because a violation occurred." A.1013-14. This reluctance led the Court to overreact, by fashioning a sweeping test of causation—not of appropriate relief—which left "no sound basis for disruption of the merger *or other relief.*" A.1013. (emphasis added).

This denial of *all* relief because of reluctance to grant *specific* relief defies this Court's *Borak* commands in two

separate respects. First, the reluctance to "unscramble" conflicts directly with this Court's pronouncement that "there is no reason to emasculate the securities laws by forbidding remedies which might prove to be essential. *Cf. J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). On remand, the trial court may order a return to the *status quo ante* . . . ." *SEC* v. *National Securities, Inc.*, 393 U.S. 463-64 (1969). Second, in *Borak* this Court specifically enumerated alternative monetary remedies in "damages" or "restitution", which might be employed in lieu of specific rescission to discharge "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." 377 U.S. at 433. *Borak* itself involved a merger already consummated, and the duty it imposed is the duty to provide effective remedies at *that* time, not when prospective relief is sought.

The Court of Appeals disregards that duty by laying down a rule for consummated mergers which will exculpate the fraudulent proxy solicitor in every case where the merger is found to be within the limits of fairness when measured by the merits of its substantive terms. Moreover, exculpation is likely to be universal as a practical matter, and the possibility of relief if fairness is not found, held out by the Seventh Circuit's rule, will prove illusory in practice. By requiring an expensive and exhaustive trial of the merits of the corporate transaction as a pre-condition to a determination of liability in every suit, the decision below will effectively stifle enforcement by small shareholders like these petitioners. The Seventh Circuit's holding, if unreversed, will thus emasculate this Court's *Borak* decision and its animating purpose to encourage private enforcement actions.

5. *The interest to be protected in merger cases.* In *Borak* this Court declared that "To hold that derivative actions are not within the sweep of the section would . . . be tantamount to a denial of private relief." 377 U.S. at 432. Such actions, to vindicate the interests of the corporation rather than of the stockholder, are essential to effective enforcement because "The injury which a stockholder suffers from corporate action pursuant to a deceptive proxy solicitation ordinarily flows from the damage done the corporation, rather than from the damage inflicted directly upon the stockholder." 377 U.S. at 432. When the corporate action at stake is merger into another corporation, as here, the "damage done the corporation" is, inevitably, the extinguishment of its corporate existence and the invasion of its right to continue to do business unless and until dissolved by authorization lawfully procured. Reaffirming this aspect of its *Borak* decision, the Court has ruled that misleading proxy solicitation is actionable under federal law, despite approval of the merger under state law, when the "deception furthered a scheme which resulted in their losing their status as shareholders in [the original corporation] and becoming shareholders in a new company." *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969).

In the face of this binding authority, the Court of Appeals discarded the petitioners' position "that Autolite had a right to a separate existence which the court must vindicate against unlawful interference, and [their] claim [of] their own rights to be shareholders of Autolite, unaffected by votes at a meeting where the information supplied to the electorate did not meet the standards of the 1934 act." A.1012. The invasion of these interests, in that court's opinion, did not amount to any "inequity or damage which the court should relieve or redress." A. 1011.

This disregard of *Borak's* authority ignores as well the explicit declaration of Congress that the merger contract, made in violation of the Act, is "void" insofar as the rights of the violator are concerned. Section 29(b), Securities Exchange Act of 1934, 15 U.S.C. §78cc(b). This declaration precludes exculpating a transaction authorized by votes illegally solicited on the theory that the illegal solicitation was "harmless." The Fifth Circuit recognized this in *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F.2d 357, 362 (5th Cir. 1968), *cert. denied*, 393 U.S. 913 (1968), holding that the right to relief against violation of the 1934 Act is not conditioned upon establishment "that any harm which [plaintiffs] suffered was caused by" the violation; "it is sufficient to show merely that the prohibited transaction occurred and that [plaintiffs] were in the protected class." As *Borak* held, the "protected class" under §14(a) includes the corporation itself. When Congress has labelled the transaction "void", the courts are foreclosed from validating the merger by exculpating the violators, or from holding that consummation confers immunity and the transaction is exempt merely because it is considered to be substantively "fair" in its terms.

6. *The stockholders' right to fair corporate suffrage.* Speaking to the basic purpose of §14(a), the unanimous opinion of this Court in *Borak* states, "The section stemmed from the congressional belief that '[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange.' H.R. Rep. No. 1383, 73rd Cong., 2d Sess., 13. It was intended to 'control the conditions under which proxies are solicited with a view to preventing the recurrence of abuses which . . . [had] frustrated the free exercise of the voting rights of stockholders.' *Id.*, at 14." 377 U.S. at 431.

The Court of Appeals, however, ignores this declaration of purpose and is unconcerned by the corruption of the corporate suffrage. The "free exercise of the voting rights of stockholders" finds no vindication in the opinion of the court below, which refuses to "deem liability established because some of the required votes depended for validity on proxies secured by the unlawful proxy statement" (A.1013), and declines to countenance the shareholders' claimed right to be "unaffected by votes at a meeting where the information supplied to the electorate did not meet the standards of the 1934 act." A.1012. On the contrary, the Seventh Circuit by-passes the shareholders' right to a free and informed vote by embarking upon a hypothetical judicial reconstruction of the balloting, after the fact, to determine whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013. The answer to this question, in the Seventh Circuit's view, turns on prediction whether the minority shareholders of Auto-Lite would be as well off as preferred shareholders of the new corporation as they would have been as continuing shareholders of Auto-Lite. This retrospective prediction necessarily entails projection and comparison of the relative prospects of the dissolved corporation with that of the merged corporation. But that is one of the questions which the respondents illegally deprived the minority shareholders of their federally protected right intelligently to explore and resolve for themselves. To allow the court to cast their votes for them, in effect, in a judicial reenactment of the voting process, denies all right and value to the right of suffrage conferred and guarded by Congress, and enforced by this Court's decision in *Borak*.

II. BY EXPRESSLY COMPELLING PUBLIC DISCLOSURE PREDICATED UPON INVESTOR RELIANCE, CONGRESS FORECLOSED JUDICIAL INQUIRY INTO THE ACTUAL EFFECT ON SHAREHOLDER MENTAL PROCESSES

The root of error below is the Seventh Circuit's resort to the common law doctrine of "reliance" to limit the sweep of the federal securities laws. That doctrine, which the opinion admittedly imports from the field of "common law fraud" (A.1013, n. 10), actually becomes the foundation for the "corresponding" test of causation devised by the court below in its misinterpretation of *Borak*. Its ruling in this regard effectively reversed the District Court's correct holding that to require "reliance" would conflict with the underlying purpose of Congress' condemnation of misleading proxy solicitation, with the letter of §14(a) and Rule 14a-9 in their explicit terms, and with the practical necessities of enforcement of both spirit and letter.

A. The Congressional Finding of Public Reliance Was Erroneously Disregarded by the Court Below

The soundness of the District Court's rejection of reliance—and of causal requirements derived from it—is revealed in the statutory pattern of the securities laws. A proxy statement *must* accompany every solicitation for a proxy, consent, or authorization for corporate action within the Act's coverage; a proxy form may not be supplied to shareholders without the required statement. Its contents are broadcast to the investing public at large, in obedience to congressional command. In this

respect, the proxy statement is the counterpart[5] of the prospectus for newly issued securities which must be sent to every prospective purchaser under §5(b) of the Securities Act of 1933.

The general dissemination of these documents fulfills "a central aspect of national policy in the field of securities regulation", assuring that investors have "access to enough information to enable them to arrive at their own rational decisions." THE WHEAT REPORT 10.[6] Addressed to the average unsophisticated investor rather than to the informed specialist, they are intended by Congress to supply the basis for action by the recipient. The requirement that such information must be supplied is founded upon the congressional premise that investors should and will make use of it. In short, a legislative finding of reliance is the statutory foundation. Management may not excuse a failure to send the required document by asserting that the recipients would not read it anyway, nor may it avoid the consequences of a misleading statement by claiming that it was not read or relied upon in fact. A statement broadcast to the investing public will have inevitable if undiscernible effects upon the market as a whole, affecting every transaction in the security to

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[5] THE WHEAT REPORT recognizes the parallel between the function of the proxy statement in providing disclosure to the trading market in previously issued securities and the function of the prospectus in the marketing of new issues. DISCLOSURE TO INVESTORS, REPORT AND RECOMMENDATIONS TO THE SECURITIES AND EXCHANGE COMMISSION FROM THE DISCLOSURE POLICY STUDY, "THE WHEAT REPORT," 41, 376-77 (March 27, 1969) (hereinafter cited as THE WHEAT REPORT). In mergers and other corporate combinations, the proxy statement and prospectus operate interchangeably to serve the federal policy of disclosure. *Id.* at 74, 277, 381.

[6] See note 5, *supra.*

some degree. Congress has required disclosure in the belief that the public should have an affirmative source of information on which they can rely, and has created conditions designed to invite and to foster that reliance. The courts are not free to call this policy into question, nor to impede its effectuation through decisions which tend to discourage the very reliance which Congress meant to promote.

Whether investors in any case *do* rely, or *are* misled, is accordingly irrelevant, for in Congress' view, material non-disclosure inevitably *tends* to deprive investors of information which they should have and inevitably *tends* to mislead. *Cf. Rogers* v. *Guarantee Trust Co.*, 288 U.S. 123, 143 (1933). Because the evil at which Congress struck was this tendency, whether investors actually did rely on or were misled by a material non-disclosure is no more relevant in a Section 14(a) case than the question whether employees were actually coerced by employer "interference, restraint or coercion" is relevant in an unfair labor practice case.[7] "It is the *tendency* of [unlawful conduct] to weaken or destroy [statutory rights] that is controlling." *NLRB* v. *Burnup & Sims*, 379 U.S. 21, 23-24 (1964) (emphasis added).

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[7] The Seventh Circuit's holding in *NLRB* v. *Illinois Tool Works*, 153 F.2d 811, 814 (1946), is a classic statement of the rule:

> "[T]he test of interference, restraint and coercion under §8(1) of the Act does not turn on the employer's motive or on whether the coercion succeeded or failed. [Citations omitted.] The test is whether the employer engaged in conduct which, it may reasonably be said, tends to interfere with the free exercise of employee rights under the Act." (Citations omitted.)

B. The Congressional Purpose of Compulsory Disclosure Excludes Consideration of Actual Deception

The Seventh Circuit considered the controlling question to be whether the particular misleading statement actually "caused the submission of sufficient proxies." A.1013. The court noted that at common law the question would be phrased in terms of reliance. A.1013, n. 10. This resort to reliance stemmed from a misconception of the statutory purpose of *disclosure*.[8] Anti-fraud provisions of the securities acts, reinforcing the common law, are sufficient to condemn actual deception in securities transactions. Reaching beyond these narrow confines, Congress added Section 14(a) to condemn silence, not falsehood, and to command "Tell the full story", not merely to repeat "Tell no lies." Congress requires "not simply truth in the statements volunteered, but disclosure." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963), quoting SHULMAN, *Civil Liability and the Securities Act*, 43 YALE L.J. 227, 242 (1933). With Congress' authority, the SEC proxy rules affirmatively compel the revelation of specified information. The proxy solicitor may not remain silent, saying he misled no one because he said nothing; he has the duty to speak.

The distinctive public purpose of disclosure is two-fold. First, the stability of the securities market depends upon the confidence of the investing public in the completeness and reliability of information provided. The effects of the decision below were foreseen by the late Judge

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[8] The need for judically tailored private remedies, unrestricted by ordinary common law requirements, is "strongest when the rule imposes an explicit duty unknown to the common law." *Colonial Realty Corporation* v. *Bache & Co.*, 358 F.2d 178, 182 (2d Cir. 1966), *cert. denied*, 385 U.S. 817 (1966).

Jerome Frank: "The unfortunate consequences will be that those in control may be immunized from effective attacks on their misdeeds, and, as a result, the small investors will lose confidence in all corporate managements, the honest as well as the dishonest." *Subin* v. *Goldsmith*, 224 F.2d 753, 767 (2d Cir. 1955) (dissenting opinion). Whether or not anyone is actually deceived, concealment of conflicts of interest by those who undertake to advise will inevitably undermine that investor confidence which is vital to a sound economy. Speaking of such an undisclosed conflict of interest in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963), this Court confirmed this special function of disclosure: "Experience has shown that disclosure in such situations, while not onerous to the adviser, is needed to preserve the climate of fair dealing which is so essential to maintain public confidence in the securities industry and to preserve the economic health of the country."

The second object of compulsory disclosure, also independent of fraud, reliance, or actual deception, is found in the prophylactic function of exposure. Thus, "one of its most valuable consequences is the elimination of conflicts of interest and questionable business practices which, exposed to public view, have what Justice Frankfurter once termed 'a shrinking quality.'" The Wheat Report, *supra* note 5, at 51. In Justice Brandeis' words, "Sunshine is said to be the best of disinfectants and electric light the most efficient policeman." Brandeis, Other People's Money c. V, 62 (NHLF ed. 1914). "The Act presupposes that the glaring light of publicity will give the investors needed protection. . . . [T]he requirement that the truth about securities be told will in and of itself prevent some fraudulent transactions which cannot stand the scrutiny of

publicity." DOUGLAS, *Protecting the Investor*, 23 YALE REV. (N.S.) 508, 523-34 (1933), quoted in THE WHEAT REPORT, *supra* note 5, at 53. In the context of undisclosed conflict of interest, this Court observed, "Failure to disclose material facts [is unlawful] for, as the experience of the 1920's and 1930's amply reveals, the darkness and ignorance of commercial secrecy are the conditions upon which predatory practices best thrive." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200 (1963).*

Nondisclosure of material facts, such as conflict-of-interest relationships, undermines public confidence in the securities market and provides a cloak for predatory practices, without regard to whether any investor is actually induced by ignorance to take specific action which he would not have taken with knowledge of the facts. The Seventh Circuit's reliance-causation test is wholly alien to the congressional purposes of compulsory disclosure: to preserve investor confidence in the securities

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* This two-fold purpose of disclosure, apart from the prevention of actual deception, is summarized in the SEC's special study of the disclosure policy of the securities laws:

> "Disclosure is and has from the outset been a central aspect of national policy in the field of securities regulation. The emphasis on disclosure rests on two considerations. One relates to the proper function of Federal government in investment matters. Apart from the prevention of fraud and manipulation, the draftsmen of the '33 and '34 Acts viewed that responsibility as being primarily one of seeing to it that investors and speculators had access to enough information to enable them to arrive at their own rational decisions. The other, less direct, rests on the belief that appropriate publicity tends to deter questionable practices and to elevate standards of business conduct." THE WHEAT REPORT, *supra* note 5, at 10.

markets as places of fair and open dealing, and to deter overreaching and questionable conduct, through the prophylaxis of public scrutiny. The injection of the extraneous reliance-causation requirement into enforcement suits obstructs achievement of these legislative goals.

C. The Statutory Scheme Eliminates Reliance as an Element of the Civil Remedy

Combating the dual evil of nondisclosure — undermining public confidence and fostering secrecy for predatory practices — is a principal object of the proxy statement and of the prospectus. Judicial inquiry into "reliance" on these documents, or into kindred questions of causation, is forbidden by the letter of these disclosure laws as well as by their spirit. When Congress has intended to require reliance as a condition to civil liability for breach of a statutory command, it has imposed the requirement explicitly. For example, reliance is specifically stated as a prerequisite to the statutory civil remedies created for violations of the filing requirements of the 1933 and 1934 Acts, directing registration with and reporting to the SEC. Filing is intended primarily to facilitate official surveillance, and only incidentally to inform the investing public by a process of "filtration" through experts.[10] Since neither the purpose nor the probability is to reach the typical investor, there is no statutory premise of reliance, and there is need for a factual inquiry into whether the false report or registration statement influenced the decision of the particular investor who complains.[11]

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[10] *See* THE WHEAT REPORT, *supra* note 5, at 52-53.

[11] Under §11 of the 1933 Act, it is a defense that the security buyer knew the truth, and if the falsehood in the registration statement has been corrected by a sub-

Anti-fraud sections of the securities laws cover individual transactions with their particularized communications, where no general duty to provide a written statement is imposed. In such cases, broadly analogous to common law actions for fraud or deceit, there may be justification for requiring proof not only that some misrepresentation was made, but that it was also relied upon.[12]

On the other hand, in providing the civil remedy for violation of a duty to supply the investing public with full and truthful written statement of material information, Congress intentionally omitted any requirement of reliance. Under Section 12 of the 1933 Act (15 U.S.C. §77*l*), the violation of the prospectus requirements, without more, creates liability in favor of the purchaser, and gives him a right to rescission and restitution, to recover the consideration paid, or for damages. This strict liability "was intended to substantially change the common law concept of liability for fraud and deceit" and "to ensure the full and truthful disclosure of all perti-

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[11] (Continued)
sequent earning statement, reliance must be shown, although without proof of the reading of the registration statement. 15 U.S.C. §77k. Under §18(a) of the 1934 Act, a parallel requirement of reliance is imposed upon the civil remedy for falsehood in any registration statement, application, report, or document filed with the SEC under that Act. 15 U.S.C. §78r.

[12] Under anti-fraud sections like §17 of the 1933 Act (15 U.S.C. §77q) and §10(b) of the 1934 Act (15 U.S.C. 78j(b)), absent some fiduciary relationship, reliance has been judicially required. See *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 462-64 (2d Cir. 1965). *But see Myzel* v. *Fields*, 386 F. 2d 718 (8th Cir. 1967) *cert. denied*, 390 U.S. 951 (1968); *Voege* v. *American Sumatra Tobacco Corporation*, 241 F. Supp. 369 (D. Del. 1965).

nent facts to undisclosed and unidentified prospective purchasers, and to leave the fraud remedies . . . to the more intimate and isolated transactions involving known or identifiable prospective purchasers." *Woodward* v. *Wright*, 226 F. 2d 108, 116, 115 (10th Cir. 1959). Congress meant to impose a heavy burden of "responsibility for reprehensible acts of omission or commission on those who purport to issue *statements for the public's reliance*". *See* H. R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933); 266 F. 2d at 116. (Emphasis added).

> "Having explicitly prescribed the conditions of recovery in rescission or damages, we cannot read other common law requirements into the 'special right'. To say that purchaser reliance is a prerequisite to seller liability is to import something into the statute which is not there. See [2 LOSS, SECURITIES REGULATION, 966, 999 (1st ed. 1951)]. The statement in the prospectus mailed to the appellants contained material false statements. The trial court so found and there can be no doubt about it. They were communicated for the purpose of inducing the appellants to purchase the oil properties. ... We think the proof brought the appellants within the remedy afforded by [the statute] and they are entitled to recover thereunder." (*Woodward* v. *Wright*, 266 F. 2d 108, 116 (10th Cir. 1959)).

The same policy controls when, as here, a defendant seeks to introduce the question of reliance in the guise of causation. In *DeMarco* v. *Edens*, 390 F. 2d 836 (2d Cir. 1968), the Second Circuit rejected the argument that the required written statement did not "cause" the investor's purchase when it was not delivered until after the transaction was completed. "Were we to support appellees' contention we would, in effect, be erroneously introducing an element of reliance into the construction of Section 12(2)." 390 F. 2d at 841.

In *Borak*, this Court found an implied civil "cause of action for rescission or damages" for a violation of §14(a) of the 1934 Act (377 U.S. at 428), analogous to the statutory civil cause of action "for rescission or damages" for a violation of §5 of the 1933 Act. In fashioning this civil remedy, this Court cited and relied upon its decision involving the statutory civil remedy afforded by §12 of the 1933 Act. The parallel in remedies needed to enforce the parallel purpose and disclosure duty was recognized: "In passing on almost identical language found in the Securities Act of 1933, the Court found the words entirely sufficient to fashion a remedy to rescind a fraudulent sale, secure restitution and even to enforce the right to restitution against a third party holding assets of the vendor. *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282 (1940)." *Borak*, 377 U.S. at 433. Consistently with the statutory pattern, the implied civil remedy for a deficient proxy statement thus matches the statutory civil remedy for a deficient prospectus,[13] enforcing the common congressional purpose in requiring that full and truthful information be furnished to each member of the investing public whose action the solicitor seeks to induce, whether giving a proxy or buying stock.[14] In either case, no requirement of "reliance" is imposed.

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[13] The Wheat Report has recommended that this judicially implied remedy should be confirmed by administrative action, to make explicit the availability of the remedy of §12 of the 1933 Act in mergers and other corporate combinations "if the disclosure document used in soliciting the votes of shareholders of the acquired corporation is defective". The Wheat Report, *supra* note 5, at 277-78.

[14] It is to be noted that when a proxy statement is used to solicit proxies for approval of a merger, those whose proxies are sought are prospective purchasers of the surviving corporation's securities as well as voters. *See, e.g.*, *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 467 (1969).

D. The Relevant Causal Relationship Is Between the Unlawful Proxy Solicitation and the Merger

The letter of §14(a) confirms the absence of any requirement of reliance, and the irrelevance of any inquiry into whether investors were actually misled. To "provide such remedies as are necessary to make effective the congressional purpose", that is, the "broad remedial purposes . . . evidenced in the language of the section which makes it 'unlawful for any person . . . to solicit . . . any proxy . . . in contravention . . . '" of the SEC rules, this Court held that "private parties have a right under §27 to bring suit for a violation of §14(a) of the Act." *Borak*, 377 at 433, 431-32, 430-31. The *violation* which alone creates the necessary remedy is the *solicitation* of the proxies, not the specific misstatement or omission. Congress did not merely condemn transactions effectuated through fraud or deceit, elsewhere prohibited; the offense is the solicitation itself, when the proxy statement makes "deceptive or inadequate disclosure". *Borak*, 377 U.S. at 431. Thus both courts below correctly held "that mailing the proxy statement was unlawful under 15 U.S.C. Sec. 78n(a) (sec. 14(a))." A.1011.

The test of causation is correspondingly confined to "the causal relationship of the proxy material and the merger...." *Borak*, 377 U.S. at 431. The question is only whether the "consummated merger . . . was authorized pursuant to the use of a proxy statement . . . contain[ing] false and misleading statements violative of §14(a) of the Act", (*Id.*, at 428), or whether there was any "corporate action pursuant to a deceptive proxy solicitation" *Id.*, at 432.

The Court of Appeals, however, demanded the answer to "the more exact question . . . whether the misleading statement and omission caused the submission of suffi-

cient proxies." A. 1013. The causal test laid down by this Court, between "the proxy material and the merger," is narrowed to the "more exact" test of the "causal relationship between the *deficiency* in the proxy statement and the merger." A. 1012 (emphasis added). Through this re-writing of the question, the Court demands more than a showing that votes produced by the unlawful solicitation were essential to, and did, authorize the merger; it demands a showing that a sufficient number of votes were actually changed by the specific misleading omission to bring about a different result.[15] It thus imports the fraud test under which a plaintiff must prove he "relied" on the falsehood, and further requires, beyond the common law, that this "reliance" must have tipped the scales. Although the Court of Appeals shifts the burden of proof, petitioners are still compelled to litigate this impalpable issue and to produce evidence of some kind

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[15] In labor elections, the Seventh Circuit has taken a strikingly different approach. See *Allis-Chalmers Manufacturing Company* v. *NLRB*, 261 F. 2d 613 (7th Cir. 1959); *Celanese Corporation of America* v. *NLRB*, 279 F. 2d 204 (7th Cir. 1960), *vacated for reconsideration*, 365 U.S. 297 (1961) *on remand*, 291 F. 2d 224 (7th Cir. 1961), *cert. denied* 368 U.S. 925 (1961). When mailings are sent to employees in a representation campaign, misleading omissions void the election, with no hesitation for speculation about whether the same vote would have followed because the winning union had "merit", or whether the union members "relied" on the mailed statement or its misleading portions. The objectors are not required "to have canvassed the employees to ascertain why or how they voted...." *Celanese Corporation of America* v. *NLRB*, *supra*, 291 F. 2d at 226. "No one knows the importance of the . . . plan to the voting employees. Lacking the means of dependable subjective investigation, the law requires that no untruth be spoken in regard to the plan . . . ." *Allis-Chalmers Manufacturing Company* v. *NLRB*, *supra*, 261 F. 2d at 616. On the question of causal relationship, it is enough to render the election void that the misleading omission was material.

to rebut the respondents' showing. For this purpose, the Court remanded the case for a trial on the issue whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013. At one stroke, the court below thus stultified the broad purpose of disclosure distinctive to §14(a), and remitted the investing public to whatever protections may be afforded by the common law actions for fraud and deceit. The unique function of a disclosure statute, dispensing with any inquiry into actual deception, is nullified. Contrary to the command of this Court in *Borak,* the violation of §14(a) gives rise to no remedy in the Seventh Circuit's view; the cause of action is complete only when the requisite of the action for common law deceit is satisfied by determining "whether the injured party relied on the misrepresentation." A. 1013, n. 10.

III. THE SEVENTH CIRCUIT'S RELIANCE-CAUSATION TEST REQUIRES UNWORKABLE SPECULATIVE INQUIRY INTO SHAREHOLDER MENTAL PROCESSES IN VIOLATION OF THE POLICY OF THE ACT

Even if Congress had not eliminated reliance (and derivative tests of causation) from the civil remedy for violation of a compulsory disclosure statute, no such requirement could feasibly be interposed for determination upon evidence produced at a trial. When the corporate action in question "results not from the deceit practiced on [the plaintiff] alone but rather from the deceit practiced on the stockholders as a group" (*Borak,* 377 U.S. at 432), the machinery of a judicial trial can provide no answer to the question whether the collective mass decision was controlled in fact by the truth and not the false-

hood in the proxy statement, or would have been different if undisclosed information had been revealed. With direct factual resolution impossible, any requirement of reliance or of related causal standards, if otherwise proper, must be satisfied by the intended, reasonable, and probable effect of the violation, and by its natural tendency, not by proof of actual mental processes.

Two courts below have found that the respondents' nondisclosure of the directors' conflict-of-interest position constituted the omission of a "material fact necessary in order to make the statements therein [the directors' pro-merger advice] not false or misleading", "at the time and in the light of the circumstances under which" the advice was given, in violation of Rule 14a-9. The finding of materiality means that " 'a *reasonable* man would attach importance [to such a fact] in determining his choice of action in the transaction' " and that the nondisclosure " 'in reasonable and objective contemplation' . . . may affect the desire of investors to buy, sell, or hold the company's securities.'"[16] Respondents' pro-merger recommendation itself establishes that they "intended that action be taken in reliance on the claimed disinterestedness of the [advice] and its exclusive concern for the [shareholders'] interests." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-93, n. 39 (1963). This intended, reasonable, and probable effect on the minds of the investors did not warrant holding the perpetrators liable for the expected consequences, in the opinion of the court below, without a further finding, as a matter of fact, that the investors' minds were actually changed.

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[16] *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied sub nom. Coates* v. *SEC* and *Kline* v. *SEC*, 89 S.Ct. 1454 (April 21, 1969).

A. The Seventh Circuit's "But For" Test Is More Restrictive Than Common Law Requirements

The Seventh Circuit's opinion ascribes its unworkable causation test to the "corresponding" question drawn from "common law fraud." A. 1013, n. 10. Even if, stultifying the broad remedial purposes of the federal securities law, it were proper to "read the statute, in effect, as confined by traditional common-law concepts of fraud and deceit," (*SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 185 n. 6), still even the common law would reject such a narrow test. The Seventh Circuit's rationale was dealt with by Mr. Justice Cardozo in *DeCicco* v. *Schweizer*, 221 N.Y. 431, 438, 117 N.E. 807, 810 (1917), in characteristic phrases which expose the fallacy: "The springs of conduct are subtle and varied. One who meddles with them must not insist upon too nice a measure of proof that the spring which he released was effective to the exclusion of all others." It follows that when truth and falsehood are mingled, the lie need not be the sole inducing cause of the plaintiff's act,[17] and that the requisite

[17] *Cf. Longwith* v. *Butler*, 8 Ill. 32 (1845), where the Illinois Supreme Court, in dealing with common law fraud, answered the defendants' argument that "the complainant has not proved that the persons whom the purchaser induced not to bid for the land, were actually influenced in their actions by the inducement so held out to them," by stating at page 43: "It is sufficient to taint this transaction and avoid its effects, that the purchasers here have sown the seeds of evil. It is not for them to say that they have not taken root and borne their legitimate friut. . . . Human action hardly ever spring from one cause alone, but most generally from a combination of causes. But few men can trace their actions with certainty, to a preponderating motive. At the time they act, they have often become unconscious of many of the influences which indeed produced the result, and it is but too common for human nature to beguile itself into the belief that the motive which produced the act, was proper and unobjectionable, and that other less innocent causes, though they presented them, exercised no influence."

causal relationship is not rebutted by showing that the plaintiff "would have acted as he did independently of the existence of the" fraud. *Cf. Peterson* v. *Greenville*, 373 U.S. 244, 248 (1963). This rudimentary principle of common law is exemplified in the RESTATEMENT OF RESTITUTION, under the heading "Causation and Materiality":

> "*Illustrations:*
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> • • •
>
> 3. A misrepresents to B that a corporation, the shares of which he wishes to sell to B, has assets of $1,000,000, has earned an average of 10 per cent. upon its capitalization for the past five years, and has made specified contracts with others. The last statement is untrue. B purchases the shares relying upon all these representations, although he would have made the purchase if the first two statements alone had been made. B is entitled to restitution." (RESTATEMENT, RESTITUTION *p.* 37, §9(2), *Comment (a), Illustration 3* (1936).)

Under the mechanistic "but for"[18] test of reliance-causation applied below, the RESTATEMENT'S facts would be repugnant and self-contradictory, since the Seventh Circuit would not tolerate a conclusion that the victim was "relying upon all these representations, although he would have made the purchase" without the misrepresentation. The Seventh Circuit's demand for "causation in a strictly mathematical sense"[19] is thus more rigid than common law standards, where neither reliance nor causation is disproved by the fact that the victim would have taken the same action without the fraud. Surely Congress' reme-

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[18] A.1013, n. 10.

[19] *Globus, Inc.* v. *Jaroff*, 271 F.Supp. 378, 381 (S.D.N.Y. 1967). The prerequisites to plaintiff's summary judgment enumerated in that opinion are here established without genuine controversy by respondents' admissions.

dial objective is at least no more demanding than the common law, and is satisfied when the misleading statement is part of a series of representations, all material, influential, and contributing in undiscernible degree to a single, inseparable act.[20]

B. Since Subjective Inquiry Into Stockholders' Mental Processes Is Impracticable, The Intended, Reasonable, and Probable Tendency of the Proxy Statement Controls

Although neither causation nor reliance, if required, would be disproved by a finding "that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found" (A. 1013), the court below remanded the case for a trial on that issue alone. The opinion eschews direct resolution of that question, however, conceding, "Reliance by thousands of individuals, as here, can scarcely be inquired into." A. 1013, n. 10. In this holding, at least, the Court of Appeals

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[20] In *Laurenzano* v. *Einbender*, 264 F. Supp. 356, 361 (E.D.N.Y. 1966), the District Court rejected a "but for" test and found causation "[a]lthough the proxy solicitation was not a necessary or indispensable ingredient of the execution of the transactions. . . ." Such a "but for" test, applied to the *proxy solicitation*, not to the specific misstatement or omission contained, had been employed in *Barnett* v. *Anaconda Company*, 238 F. Supp. 766 (S.D. N.Y. 1965), to support a conclusion of no causation when the votes produced by the proxy solicitation were unnecessary to approval of the corporate action. That conflict of authority need not be resolved here, since in this case the minority shareholders' votes were essential to approval of the merger, and the merger could not have been approved "but for" the proxy solicitation. *Cf. Klopot* v. *Northrup*, 131 Conn. 14, 37 A.2d 700 (1944). No authority has been found which would support the Seventh Circuit's "but for" test as applied to the specific misstatement or omission.

was eminently correct. Voters themselves are unaware of the factors which influenced their choice, as has been repeatedly demonstrated not only in corporate elections[21] but in political[22] and labor[23] electoral processes as well.

In order "to provide such remedies as are necessary to make effective the congressional purpose", (*J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433), within the practical realities of the judicial process, the law is satisfied when the intended, reasonable, and probable effect of the misleading communication is to influence the stockholders to vote in a particular way, and when that intended, reasonable, and probable vote is cast in fact. This practical reasoning is exemplified by the District Court's opinion in *Union Pacific R. Co.* v. *Chicago and North Western Ry. Co.*, 226 F. Supp. 400, 411 (N.D.Ill. 1964):

> "It cannot be said with indisputable certainty that the use of the [misleading proxy material] necessarily defeated an otherwise favorable vote on the Union Pacific merger. . . .
>
> To require direct proof that the votes of a critical number of shares were changed by the [misleading

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[21] ARANOW AND EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 510 (2d ed. 1968).

[22] CAMPBELL, CONVERSE, MILLER & STOKES, THE AMERICAN VOTER 523 (1960): "The explanations offered for an electoral result are astonishingly varied; they depend typically on the slenderest evidence, and disagreements are commonplace even among knowledgeable observers."

[23] BOK, *The Regulation of Campaign Tactics in Representation Elections Under the National Labor Relations Act*, 78 HARV. L. REV. 38, 40 n. 8 (1964): "[V]ery cumbersome investigations would have to be made in a very large number of cases. Moreover, the testimony received would often be unreliable . . . because voters may be largely unaware of the true reasons for their ultimate decision. . . ."

proxy material], and more precisely by its misleading portions, would raise insuperable obstacles to relief and nullify the legislative purpose. The present state of understanding of human mental processes does not enable us to weigh with exactitude the components of decision or to determine scientifically that any particular element was controlling. The law does not ask more than human knowledge can supply. The substantial probability of a different result if improper evidence had not been submitted suffices to set aside the vote of a jury. The same standard applies in reason to the stockholders' vote."

In keeping with the limits of practicality, the application of this standard does not—and did not in that case—depend upon "any evidence introduced regarding either probability or certainty that the vote was affected. . . . It is difficult to see how the question could be otherwise decided . . ." upon an evidentiary foundation. JENNINGS AND MARSH, SECURITIES REGULATION: CASES AND MATERIALS 1001 (2d ed. 1968). Other leading commentators agree that the tendency—not the fact of actual deception—must control. "In recognition of this fact, judges and administrators have agreed that actual interference with an election need not be shown to establish a violation of the law; it is enough that the conduct in question *tends* to have these effects." BOK, *The Regulation of Campaign Tactics in Representation Elections Under the National Labor Relations Act*, 78 HARV. L. REV. 38, 42 (1964).[24] "When the complaint is of fraud in the solicitation of proxies, it should not be necessary to show that any stockholders were actually deceived if the misrepresentations are sufficiently material that they *might* have voted differently."

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[24] Citing *Republic Aviation Corp.* v. *NLRB*, 324 U.S. 793, 798-800 (1945). *Cf. NLRB* v. *Donnelly Garment Co.*, 330 U.S. 219, 231 (1947).

Loss, *Private Actions Under the Proxy Rules*, 73 HARV. L. REV. 1041, 1074 n. 131 (1961).

The impracticality of any attempt to hold a trial to inquire into the stockholders' mental processes is compounded where, as here, the defect in the proxy statement is an omission. Unlike an affirmative misstatement, an omission would require not a determination of what, in fact, occurred in the investors' minds, but a hypothetical conjecture into what might have occurred—but did not—had the fact been disclosed. Since no competent evidence could be introduced to aid the decision, any requirement of "reliance" in cases of nondisclosure could be "little more than a formal requirement." *Mader* v. *Armel*, 402 F. 2d 158, 162-63 (6th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969); 3 Loss, SECURITIES REGULATION 1765-66 (2d ed. 1961). No trial of such a hypothetical "fact" could be conducted.

In other fields, this Court has flatly forbidden the sort of exculpatory speculation countenanced by the court below. In *American United Mutual Life Insurance Company* v. *Avon Park*, 311 U.S. 138, 144 (1940), the Court said:

> "Where it does not affirmatively appear that full and complete disclosure of the [directors' adverse] interests was made to the [shareholders] when their assents were solicited, it cannot be said that those assents were fairly obtained. Cf. *Rogers* v. *Guaranty Trust Co.*, 288 U.S. 123, 143."

In the passage cited from *Rogers*, Chief Justice Stone, dissenting, said:

> "We need not conjecture whether, if the directors had had the hardihood to disclose [their adverse in-

terest] in advance . . . the stockholders would nevertheless have given their approval."[25]

Refusal to permit speculation to relieve corporate insiders of the consequences of a breach of the duty imposed by Section 14(a) is singularly necessary where, as here, the breach consists of a violation of the historic fiduciary duty of insiders fully and fairly to disclose to the shareholders the directors' own tainted loyalty. Inevitably, the most influential factor in a shareholder's decision will be the recommendation and advice of his board of directors when unopposed and believed to be unbiased. In connection with this critical factor, the courts below found a material nondisclosure in violation of the law, and found that the consequently unlawful proxy solicitation was essential to approval of the merger. The courts below also agreed that any attempt to probe into the mental processes connecting the nondisclosure with the favorable vote, through evidence introduced at a trial, would be impractical and feckless. In this situation, there is no feasible alternative to—and no permissible escape from—the logical inference which led Congress to declare the proxy solicitation unlawful. Congress having outlawed deceptive proxy statements because of their tendency to mislead the shareholders, it is not for a court to reevaluate the legislative findings or to draw different inferences on its own appraisal of the probabilities. See *Katzenbach* v. *McClung*, 379 U.S. 294, 303-05 (1964).

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[25] See also *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968). There the Court set aside the action of an arbitration board for nondisclosure of financial relations between a member of the panel and one of the parties, over the argument that the potential conflict of interest could not have affected the outcome or "caused" the award since the decision was rendered unanimously by a three-man panel of arbitrators, and since the complaining party's attorney had conceded that probably he would have taken no action to exclude the challenged arbitrator if the facts had been disclosed.

IV. A JUDICIAL RECONSTRUCTION OF THE STOCKHOLDERS' VOTES CANNOT BE PREDICATED ON THE FAIRNESS OF THE MERGER

Rejecting the congressional inference, and the consequent principle that insiders "cannot accomplish by deception what they might have accomplished honestly and then be heard to say that the deception was not the cause", (*Eagle* v. *Horvath*, 241 F. Supp. 341, 344 (S.D. N.Y. 1965)), the Seventh Circuit insisted upon a trial of the abstract and supposititious issue whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading...." A. 1013. Bowing to reality, the opinion eschews a direct approach to this issue as impractical and, compounding the error, resorts instead to indirect conjecture to determine circuitously the shareholders' hypothetical state of mind, based upon a presumption that minority stockholders would authorize any merger, without unlawful inducement, if its terms "were in fact fair and equitable" to them.[26] A. 1012. The presumption is both insupportable as a matter of fact and impermissible as a matter of law.

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[26] The Seventh Circuit's brand of logic, rigorously pursued to it conclusion, would lead not to the question whether the merger's terms were "fair and equitable" in the objective sense of a relatively equal bargain, but rather to the question whether the offered deal was favorable enough — fair or not — to garner sufficient votes to carry the merger. The lowest price acceptable to the smallest percentage of shareholders needed to approve the merger would therefore tip the scales of probabilities, and, in the Seventh Circuit's view, immunize the merger, no matter how much higher the "fair" price, objectively determined might be. Petitioners, of course, dispute the suggestion that the terms of merger could be called "fair" by any standard, but take the position that litigation of any such speculative question is irrelevant to their rights.

A. The Seventh Circuit's Conclusive Presumption of Shareholder Approval If the Merger Were Fair Is Unfounded in Fact

On the factual side, it simply defies experience to presume conclusively[27] that the shareholders of every corporation are so eager to merge that they hold out the standing invitation: No fair offer refused. Here the minority stockholders were called upon to decide whether they chose to relinquish their position as common share owners of a half interest in an automotive parts business and to accept instead the tendered status of preferred shareholders with a one-fourth interest in a new and untried conglomerate heavily involved in the manufacture of printing machines. As investors, not speculators, their interest was not confined to tomorrow's relative market quotations for the securities. They were entitled to appraise the investment prospects for themselves, and to vote to reject the merger offer, no matter how fair or beneficial it might appear to a financial expert or to a court.

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[27] While the court below suggests that it may be possible for the respondents "to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found" (A. 1013) by proving the merger to be fair and equitable, the court does not indicate what proof would then be required of petitioners to rebut the respondents' showing. It is obvious, however, that petitioners would be required to prove what actually happened, a virtually impossible requirement and one much more stringent than the "preponderance-of-probabilities" requirement imposed upon respondents. Whether or not the court would hold testimony from each of "thousands of individuals" (A. 1013, n. 10) to be admissible, the presumption of approval created by *prima facie* proof of fairness would as a practical matter be a conclusive and irrebuttable presumption.

The novel principles of causation announced by the court below would apply equally to a vote by proxy on the election of directors, and would lead to the equally illogical conclusion that fraud warrants no relief so long as the winner is qualified to hold office. The Seventh Circuit's notion that the "merits of the terms of merger" would support a conclusion that the outcome of the vote was not affected by the material nondisclosure cannot survive this Court's decision in *Wirtz* v. *Hotel, Motel and Club Employees Union*, 391 U.S. 492 (1968). There the question was not the elusive influence of nondisclosure on voters' minds, but the objective effect of defective union by-laws which excluded from the ballot certain candidates for union office. Anticipating the Seventh Circuit's approach, the lower courts had concluded that the election should not be set aside since the exclusion could not have affected the outcome of the voting. Examining the "merits" of the issue, they found that the victors were incumbents and had demonstrated enlightened and aggressive leadership, that there was no substantial grievance against them, that no disqualified nominee was a proven vote-getter, that the incumbents had the overwhelming advantage of a full slate of candidates, and that the insurgents who did appear on the ballot had lost by a margin of seven to one.

This Court reversed, and directed that, as a matter of law, the election must be set aside, since evidence tending to show the "merits" of the issue had no probative value to discharge the defendants' burden of proving that their violation did not affect the result of the voting. "None of the factors relied on is tangible evidence against the reasonable possibility that [the violation] did affect the outcome. Nothing in them necessarily contradicts the logical inference" that the result might have been

affected. "In short, the considerations relied on by the court are pure conjecture, not evidence." 391 U.S. at 508.

The sole justification offered by the Court of Appeals for reversing the finding of liability is to allow such a trial of "pure conjecture, not evidence" on this rejected theory that the merits control causation: "The material offered by defendants on the merits of the terms of merger suggests that it may be possible for them to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013. Under this Court's teaching in *Wirtz*, the supposed evidence[28] would have no probative value, and the trial would be fatuous.

Applicable here is this Court's observation in *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 366, note 18 (1963): "[a] substantive inquiry after the fact cannot possibly succeed in accurately ascertaining retrospectively what the outcome would have been had [the material nondisclosure not occurred]. The conditioning of relief for the [statutory] breach on a finding that a concomitant substantive breach occurred might well, therefore, result in an ultimate wrongful denial of recovery. . . ."

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[28] The only merit found by the Court of Appeals in the respondents' affidavits in response to the summary judgment motion was confined to "evidentiary material tending to show that the merger has merit and that the terms were fair and equitable to the minority shareholders". A.1012. Such a showing would neither discharge their burden of proof at trial, nor their burden on the motion to "set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e), as amended 1963. *See* Advisory Committee Note, 31 F.R.D. 648 (1962); *First National Bank* v. *Cities Service*, 391 U.S. 253, 290-91 (1968).

B. The Decision Below Stultifies the Congressional Purpose by Disenfranchising the Stockholders and Substituting a Judicial Appraisal of the Merger's Merits for Their Actual and Informed Vote

The Seventh Circuit's presumption that stockholders would approve any fair merger is unfounded in fact, but more importantly as a matter of law it is utterly destructive of the salutary purpose of Section 14(a). Congress enacted the statute in the "belief that '[f]air corporate suffrage is an important right that should attach to every 'equity security bought on a public exchange'" and to protect "'the free exercise of the voting rights of stockholders.'" *Borak*, 377 U.S. at 431. The decision below defies this remedial objective by completely disenfranchising the stockholders and substituting for their actual and informed vote a judicial appraisal of the merger's merits. The stockholder's right to cast an informed vote, declared and guarded by Congress, is effectively circumvented, along with his right to decide for himself whether the merger is fair, beneficial, and meritorious—and to reject it even so if he finds it undesirable for any good or bad reason. In effect, the court casts his vote for him, upon an after-the-fact prediction of how he would have voted if he had known the facts. The fraud which corrupted his right of suffrage is condoned "for his own good." By the alchemy of the Seventh Circuit's novel causation test, the statute guaranteeing free and informed voting in the corporate enterprise is transformed into a mere prohibition against unfair mergers, a prohibition which "would have been superfluous in view of the fiduciary standard to which [the corporate managers] were already bound under settled principles of equity." *Wolf* v. *Weinstein*, 372 U.S. 633, 645 (1963).

Once the congressional objective is clearly perceived, causation appears in proper perspective. Regardless of the probable outcome of the voting, suffrage has its own values: participatory democracy, the competition of conflicting opinion, and responsibility to the minority. Judge Dooling correctly discerned the congressional purpose in *Laurenzano* v. *Einbender*, 264 F. Supp. 356, 362 (E.D. N.Y. 1966):

> "The vote is not legally predetermined simply because it seems practically predictable. . . . If proxies are solicited, the stockholders have a statutory right to a truthful proxy statement. Misleading proxy material impeaches the validity of the meeting, its efficacy as a meeting. A majority stock holding cannot legitimate a meeting based on misleading information by reference to its possession of votes that would suffice to end debate. The misleading proxy material deprives the meeting, and the majority stockholder, of the expressions of view and the votes that would have ensued upon truthful disclosure; it is not legally possible to decide what legal consequences flow from the informational defects in the meeting by asserting that the meeting would have ended in the same resolutions no matter what the views or votes of the minority. *That is not necessarily the fact and it cannot be the resolving principle of law.*" (Emphasis added).

In public governmental elections as well as in corporate voting, the Seventh Circuit's decision would apply with as much logic to immunize interference with voting rights so long as "a preponderance of probabilities" would favor the same outcome had fair suffrage not been denied. In that field, the Fifth Circuit exemplified the necessary approach to the causal relationship between the corrupting force and the election results, in *Bell* v. *Southwell*, 376

F.2d 659 (5th Cir. 1967). There the plaintiff, an unsuccessful candidate for Justice of the Peace, sought to invalidate the election because certain voters had been intimidated in the exercise of their voting rights. The District Judge had denied relief because of the drastic and "staggering" implications of setting aside a public election, and because there was "no way to tell whether the result would have been different" in the absence of discrimination, and hence "no harm or injury is shown." The Fifth Circuit, forthrightly and realistically, rejected these reasons. The policy of freedom of elections, it held, does not permit denial of relief for "inability to demonstrate that the outcome would have been different." 376 F.2d at 662.

Congress has left it to the stockholders—not management or the courts—to decide whether the merger should go forward. In the exercise of the "fair corporate suffrage" thus conferred, they may choose to reject a fair and beneficial merger or to approve an unwise proposal. Whether a merger is good or bad is irrelevant; the stockholders have a right to be wrong. This Court declared in *Borak*, "The purpose of §14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation. . . . It was intended to 'control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which . . . [had] frustrated the free exercise of the voting rights of stockholders.'" 377 U.S. at 431. A "federal cause of action for rescission or damages to a corporate stockholder" is created by a violation of this command. *Id.*, at 428. Having found an actual violation consisting in "deceptive or inadequate disclosure," the court below ignores its "duty . . . to provide such remedies as are necessary to make effective the congressional purpose." *Id.*, at 433.

Instead, the court wipes the slate clean, absolving the violator of any consequences for his actual and established wrongdoing, and offers him a free and fresh start with the chance to persuade a judge that the merger has merit. The fraudulent insider need not risk submitting his plan, honestly and openly, to the shareholders for their fair and informed consideration. He avoids that hurdle by resorting to fraud, and is better off for having violated the law since at worst, if the fraud is discovered, he will be called upon to show to a court that his scheme has merit and is "fair and equitable to the minority shareholders." If allowed to stand, the Seventh Circuit's ruling "would place a premium on concealment [of material facts] and thereby jeopardize the salutary policies of the statute." *Wolf* v. *Weinstein*, 372 U.S. 633, 654 (1963).

C. The Seventh Circuit's Decision Renders the Act Superfluous by Making Liability Turn upon the Substantive Fairness of the Merger

The Seventh Circuit does not suggest that unfairness of the merger is an independent prerequisite to liability, but the sum total of its holding is the functional equivalent of such a ruling. Since a showing that the merger is "fair and equitable to the minority shareholders" would support a finding of no "causal relationship" under that court's opinion, the practical effect is to condition the outcome of the case on a determination of fairness, which is what respondents urged below. The court thus adopts by indirection the position argued to this Court, and rejected, in *Borak*, that "a deficient proxy statement followed by a beneficial merger gives rise to no cause of action, but a lawful proxy statement followed by a fraudulent merger is actionable. In short, the violation of §14(a) has no crucial bearing on the main thrust of the claim." Brief of Petitioners

Harry G. Barr *et al.* at 10, *J. I. Case* v. *Borak*, 377 U.S. 426 (1964). That reading of federal law was rejected by this Court in *Borak*, since if it would "attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated." 377 U.S. at 435.

The decision below transforms the broad prophylactic prohibition against seeking stockholder authorization through misrepresentation into a narrow—and superfluous—condemnation of unfair transactions. On that approach, the disclosure requirements of the federal securities laws add precisely nothing, since unfair transactions, characterized as constructive fraud, have always been actionable in state courts. Because the cause of action in this view would not turn upon federal law but would arise under the law of the state, the Sixth Circuit had held in *Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201 (6th Cir. 1961), that the federal courts have no jurisdiction, absent diversity, to entertain suits for relief against a consummated merger under Section 14(a). *Borak* overruled that decision (377 U.S. at 434), and with it the notion that liability for a violation of the proxy rules is dependent upon the merits of the merger in its substantive terms.

That the Seventh Circuit misconceived the thrust of *Borak* is confirmed by *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969), decided after the Seventh Circuit opinion was handed down. *National Securities* reaffirms that in forbidding misleading proxy solicitation for a merger, "the Federal Government is attempting to protect security holders from fraudulent misrepresentations" and "is asking . . . that . . . companies speak the truth when talking to their shareholders." The Court reasoned from this purpose that in an enforcement suit "[n]o question of the legality or illegality of the merger, standing alone, was raised", since

under the federal securities laws, "[t]he gravamen of the complaint was the misrepresentation, not the merger." 393 U.S. at 462-3. In short, the merits of the merger and its fairness are irrelevant to the violation.

Congress' objective was not to prohibit transactions which, on their merits, are unfair or unworthy; its condemnation encompasses all transactions infected by their promoters with the virus of nondisclosure. Full disclosure is required not to assure fairness, but because it is "essential to maintain public confidence in the securities industry and to preserve the economic health of the country." *SEC* v. *Capital Gains Research Bureau Inc.*, 375 U.S. 180, 201 (1963). "Section 14(a), (c) exacts candor of disclosure, not fairness of substantive terms. . . ." *Laurenzano* v. *Einbender*, 264 F. Supp. 356, 361 (E.D.N.Y. 1966). "The fundamental aim of the [disclosure] requirement was to provide information, and not to shield the public from ventures deemed to be of dubious merit." The Wheat Report, *supra* n. 5, at 49.

This Court again rejected unfairness as a prerequisite to liability for nondisclosure in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963). There the lower courts had denied relief against advice to investors, tainted by an undisclosed conflict of interest, because "no actual loss of money to clients" had been shown (375 U.S. at 184), and because it did not appear that "the investment advice was unsound" (306 F. 2d 606, 608), or that there was "actual injury to clients". 375 U.S. at 186. This Court did not pause for conjecture on whether the recommendations might still have been followed if the conflict of interest had been disclosed. The reversal was summary: "It would defeat the manifest purpose of the . . . Act . . . for us to hold, therefore, that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit,' intended to require proof of intent to injure and actual injury to

clients." 375 U.S. at 192. ". . . Congress intended a broad remedial construction of the Act which would encompass nondisclosure of material facts," not one which turns on "fraud and deceit in their technical sense", including "intent to injure and actual injury. . . ." 375 U.S. at 186, 185, 195.

D. The Seventh Circuit's Ruling Makes the Statutory Right More Restrictive Than Traditional Non-Statutory Restitution, Where Fairness Is No Defense.

Under the Seventh Circuit's restrictive interpretation, the defrauded investor is not only unaided by the congressional enactment; he is actually handicapped by the statute, and denied relief traditionally afforded in a non-statutory suit for fraud. Apart from statute, it has long been settled that misrepresentation in a security transaction entitles the misled buyer or seller to rescind the transaction and to obtain restitution of the consideration he gave without regard to the fairness of the exchange, since "in a court of equity it is the fraud, and not the damages, which entitle him to relief." *Stern* v. *Kirby Lumber Co.*, 134 Fed. 509, 510 (S.D.N.Y. 1904). *See also, e.g., King* v. *Lamborn*, 186 Fed. 21, 29 (9th Cir. 1911); *Mather* v. *Barnes*, 146 Fed. 1000, 1004 (W.D. Pa. 1906). The operative effect of the Seventh Circuit's ruling is also more restrictive than the judge-made principles specifically applicable to fiduciary transactions involving a potential conflict of interest. Prevailing equitable doctrine holds that if the conflict of interest has been fully disclosed, the transaction may survive if the fiduciary sustains his burden of proving its fairness. But without full disclosure, on the other hand, the transaction must be set aside regardless of fairness. *See* RESTATEMENT (SECOND) TRUSTS §216(3), pp. 499, 505; §170(2), pp. 364, 373; *Thruston* v. *Nashville & American Trust Co.*, 32 F. Supp.

929 (M.D. Tenn. 1940). The ruling below inverts this rule, in practical effect, to immunize the undisclosed conflict of interest if the transaction is proved to be fair.

A decent regard for legislative history demands that Section 14(a) should be treated as no worse than superfluous. If, despite its broad remedial purpose, the statute is to be read as adding nothing to the investor's right to be relieved of fraudulent transactions found to be fair in their terms, at least the statute should not *detract* from his rights, to deprive the investor of the protections afforded by traditional equitable rules of fraud. Upon this modest proposition, the District Court in *Gerstle* v. *Gamble-Skogmo, Inc.*, C.C.H. Fed. Sec. L. Rep. ¶92,367, at p. 97,749-50 (E.D.N.Y. March 7, 1969), ruled, by analogy to the equitable remedy of rescission and restitution, that the fairness or merit of a merger is no defense to a civil action for nondisclosure in the proxy statement. The Court said:

> "Assuming, *arguendo,* there was a failure to disclose a material fact in the proxy statement, defendant claims that since the plan of merger was fair the plaintiffs suffered no damages. . . . When a seller is induced to sell his property by means of a statement which he subsequently learns is false, the fact that the sales price was fair at the time is irrelevant. The seller may thereafter maintain an action in equity for a rescission of the contract and an accounting of the proceeds and the ensuing profits. If the property cannot be returned, the plaintiff is entitled to restitution. *Falk* v. *Hoffman,* 233 N.Y. 199, 135 N.E. 243 (1922). *Janigan* v. *Taylor, supra* [344 F.2d 781 (1st Cir. 1965), *cert. denied,* 382 U.S. 879 (1965)] and *Kardon* v. *National Gypsum Co.,* 73 F. Supp. 798, *modified* 83 F. Supp. 613 (E.D.Pa. 1947), decided under §10(b), have both held that damages at the time of the sale of the stock is not an element

of the cause of action if there has been a violation of the disclosure requirement. In this case the stockholders were defrauded by voting for a merger without vital information withheld by insiders. . . .

. . . The purpose of §14(a) was to prevent such frustration of stockholders (H. R. REP. No. 1383, 73d Cong., 2d Sess. 13, 14). The exercise of this right cannot be defeated by the mere promulgation of a fair plan in a merger proceeding."

V. THE DECISION BELOW STIFLES PRIVATE ENFORCEMENT SUITS, A NECESSARY SUPPLEMENT TO COMMISSION ACTION IN ENFORCING THE ACT, BY RAISING INSUPERABLE OBSTACLES TO RELIEF.

In *Borak* this Court observed (377 U.S. at 432):

"Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in anti-trust treble damage litigation, the possibility of *civil damages* or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements." (Emphasis added).

This "necessary supplement" is virtually destroyed as an "effective weapon" by the holding below. As the Court of Appeals pointed out (A. 1012), petitioners own, between them, only 5/100 of 1% of the Autolite shares. They are the "little investors" who need the greatest possible protection.[29] Yet the court below would compel

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[29] *Surowitz* v. *Hilton Hotels Corporation*, 383 U.S. 363, 371 (1966): [D]erivative suits have played a rather important role in protecting shareholders of corporations from the designing schemes and wiles of insiders who are willing to betray their company's interest in order to enrich themselves. And it is not easy to conceive of anyone more in need of protection against such schemes than little investors like Mrs. Surowitz." See also, *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967).

the small shareholder, even after he has established that the proxy solicitation was unlawful, to litigate the merits and fairness of the merger as a condition precedent to *any* relief. No small investor could afford to rebut the array of expert witnesses produced by the corporation, in discharge of its burden of proof on fairness, by himself engaging a competing array of expert financial witnesses, causing exhaustive audits and investigations of the books and records of huge corporations, by the taking of lengthy depositions, and by financing such items as the court reporting of the inevitably protracted trial. If the time, expense, and staff requirements of such an undertaking are not available to the SEC to "permit an independent examination of the facts set out in the proxy material" (*Borak*, 377 U.S. at 432), obviously the small investor, whose total stake may be less than such costs, is never in a position to match the corporate resources available to management in a full-dress trial to determine the fairness of a merger.

This Court recognized the danger of chilling private actions when it said in *Borak* (377 U.S. at 435):

> "[T]he hurdles that the victim might face (such as separate suits, as contemplated by *Dann* v. *Studebaker-Packard Corp.*, *supra*, security for expense statutes, bringing in all parties necessary for complete relief, etc.) might well prove insuperable to effective relief."

The Court of Appeals in this case assessed against petitioners all costs of that appeal, approximately $9,000 (A. 1000, 1015), on the theory that they had not yet estab-

lished liability.[30] Confronted with the prospect of such a cost bill, as a prelude to the cost of a trial on the merits and fairness of the merger, few, if any, investors could afford to litigate even the most outrageous Section 14(a) violation.

Merger litigation is not the only kind of enforcement action obstructed by the test of "causation" fashioned by the Court of Appeals, nor is the fairness or merit of a merger the only extraneous issue introduced. The lower court's rationale would extend equally to any factor which might, reasonably or unreasonably, be taken into account by an investor in making his decision, allowing the corporate insider, already found guilty of deception, to wage a defensive war of attrition by litigating everything that conceivably bears on the "probabilities" that honesty might have induced the same action by the victim: the qualifications of management, long-run prospects in the industry, tax consequences, the advice being offered by brokers and tipsters, the health of the national economy, etc.—all are potentially triable. Proxy statements for the election of directors, approval of stock-option plans, or the selection of auditors would be equally affected. Unconfined by anything in §14(a), the Seventh Circuit's ruling would also destroy the utility of actions under any other section of the securities laws, by demanding an exhaustive trial of speculation on whether the de-

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[30] The District Court's entry of summary judgment on the issue of liability constituted the granting of a declaratory judgment that the proxies had "been obtained in violation of §14(a)", a part of the relief requested in the complaint. A.179-80. The Court of Appeals affirmed this conclusion. The proper consequence of this affirmance would impose costs on respondents. The court nonetheless entered a judgment of reversal, imposing $9,000 costs on the petitioners.

frauded 10(b) plaintiff, for example, might have been willing to buy or sell at the same price had there been no fraud or manipulation.[21] As a test of causation, not of standing to sue, the lower court requirements would apply to the SEC as well as to a private plaintiff, rendering public enforcement equally impotent.[22]

In the comparable field of anti-trust treble damage litigation, described in *Borak* (377 U.S. at 432) as serving the same enforcement function as private securities suits, this Court recently considered a claimed defense, like that sanctioned by the court below, that the defendant's violation did not cause the consequences complained of. The Court rejected that comparable defense with these applicable observations on the practicalities of private enforcement:

> "Normally, the impact of a single change in the relevant conditions cannot be measured after the fact . . . . [I]t is not unlikely that if the existence of the defense is generally confirmed, antitrust defendants will frequently seek to establish its applicability. Treble damage actions would often require additional long and complicated proceedings involv-

[21] *Cf.*, for example, *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968), *cert. denied sub. nom. Coates* v. *SEC* and *Kline* v. *SEC*, 89 S. Ct. 1454 (April 21, 1969).

[22] Applied to the SEC's suit which was before this Court in *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969), seeking under Rule 10b-5 to set aside the merger allegedly consummated through misleading proxy solicitation, the Seventh Circuit's ruling would require the SEC, upon remand from this Court, to commit its limited staff and resources to an extended trial on the fairness of a merger of insurance companies, involving issues foreign to its expertise, before the relief declared by this Court to be available can be considered or granted, if relief for the violation is not indeed foreclosed by the Seventh Circuit's fairness defense.

ing massive evidence and complicated theories.

". . . In consequence, those who violate the antitrust laws . . . would retain the fruits of their illegality because no one was available who would bring suit against them. Treble damage actions, the importance of which the Court has many times emphasized, would be substantially reduced in effectiveness." *Hanover Shoe, Inc.* v. *United Shoe Machinery Corp.*, 392 U.S. 481, 492, 493, 494 (1968).

The court below implied that petitioners were at fault for not moving to enjoin the merger. A. 1011. But that imputation overlooks the obstacles confronting the private litigant. Here the violation found by the courts below was not discovered until long after the meeting to approve the merger had been held, when it was pleaded in an amendment to the complaint. A. 163. In the nature of things, minority shareholders are not privy to insider information which management might omit from a proxy statement. Discovery of the truth will normally occur only after the transaction has been completed. See *Borak*, 377 U.S. at 432-33. Preliminary injunctions are also infeasible because of the requirement of obtaining an injunction bond at prohibitive cost, or of assuming the risk of damages in the event that permanent relief were ultimately denied. Enforcement through prospective suits, whether brought by the Commission[23] or by minority shareholders, falls far short of providing "such remedies as are necessary to make effective the congressional purpose." *Borak*, 377 U.S. at 433. It is for this very reason

[23] *SEC* v. *National Securities, Inc.*, 393 U. S. 453 (1969), exemplifies a situation likely to recur. The Commission's application for preliminary injunctive relief was denied by the District Court, erroneously as it turned out. Exigencies of time prevented review before consummation, and remitted the Commission to post-merger remedies.

that this Court found no "merit in the contention that . . . remedies are limited to prospective relief." 377 U.S. at 434. To withhold any remedy because the merger itself was not enjoined is to circumvent the holding of *Borak*.

VI. THE DECISION BELOW DEFEATS THE CONGRESSIONAL POLICY BY BARRING ANY RELIEF ONCE A MERGER, LATER FOUND TO BE FAIR, IS CONSUMMATED.

In light of the Court of Appeals' ruling that the undisputed findings would support prospective relief by way of injunction in advance of the meeting (A. 1011), its holding that there is no liability for the consummated merger rests alone upon its expressed reluctance "to unscramble a corporate transaction merely because a violation occurred." A. 1013-14. No question of "unscrambling", however, was properly before that court. The District Court had postponed for future hearing the question of its duty "to provide such remedies as are necessary to make effective the congressional purpose." *Borak*, 377 U.S. at 433. Petitioner's opportunity to be heard on the form of appropriate relief was foreclosed by respondents' interlocutory appeal, under Section 1292(b) of the Judicial Code,[44] from the District Court's ruling on the issue of liability alone.

At that point, petitioners were already entitled to final judgment in their favor, regardless of further developments. The District Court has entered a partial summary judgment "on the issue of liability" under Fed. R. Civ. P. 56(c), equivalent to "an order specifying the facts appearing without substantial controversy". Fed. R. Civ. P. 56(d). On the basis of those factual findings affirmed by the Court of Appeals, the petitioners would still be entitled to judg-

[44] 28 U.S.C. § 1292(b).

ment[35] if no further proceedings were permitted, or if they had rested their case. At this juncture, petitioners are entitled to have this six-year war of attrition brought to a close, and to a preliminary judgment assuring that further proceedings would be conducted at respondents' costs.

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[35] At minimum, the right to the following remedies has already been established:

1. A declaratory judgment that the proxy statement was unlawful and that the vote authorizing the merger was illegally obtained. *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 427-28 (1964); *Dann* v. *Studebaker-Packard Corporation*, 288 F.2d 201, 216-17 (6th Cir. 1961). This relief was specifically demanded in the amended complaint. A. 179-80.

2. An injunction against violations in future proxy solicitations and transactions, in the light of past violations and a continuing nondisclosure. *SEC* v. *Okin*, 139 F.2d 87, 88 (2d Cir. 1943); *SEC* v. *Great American Industries, Inc.*, 407 F.2d 453, 458 (2d Cir. 1968), *cert. denied* 89 S.Ct. 1770 (May 26, 1969).

3. A judgment for nominal damages, to vindicate the petitioners' rights and to protect the integrity of the federal securities laws. *Sankin* v. *5410 Connecticut Avenue Corporation*, 281 F.Supp. 524, 567-70 (D.D.C. 1968) (carrying costs and attorney fees). See also *United States* v. *Mock*, 149 U.S. 273 (1893) (when a wrong but no damages are proved, plaintiff is entitled to judgment for nominal damages); *Dow* v. *Humbert*, 91 U.S. 294 (1876) (nominal damages and costs).

4. Costs and counsel fees for establishing and exposing this violation of the rights of the corporation and of the public interest. See *Sprague* v. *Ticonic National Bank*, 307 U.S. 161, 166-67 (1939); *Bakery and Confectionery Workers International Union of America* v. *Ratner*, 335 F.2d 691, 696 (D.C. Cir. 1964). See HORNSTEIN, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658 (1956).

5. An order directing respondents to render "an accounting of their unlawful gains". See *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969). *Cf. Bynum* v. *Baggett Transportation Company*, 228 F.2d 566, 573-74 (5th Cir. 1966).

Pre-empting the untendered issue of further relief, the Court of Appeals adds two unfounded assumptions: that dissolution is the only proper remedy for a consummated merger, and that dissolution is too harsh a remedy for the wrong. Neither assumption can survive examination.

This Court in *Borak* recognized the availability of a wide range of remedies for a merger consummated through a violation of the congressional disclosure requirements. "Damages" and "restitution" as well as "rescission" are mentioned by this Court. 377 U.S. at 428, 430, 433. Among these available remedies, it is the petitioners' right to choose which they will seek. See *The Fair* v. *Kohler Die & Specialty Company*, 228 U.S. 22 (1913). Although the determination of ultimate relief is not now presented for final decision, this Court is properly called upon to lay down the guidelines for further proceedings upon remand, to instruct the district courts in their "duty . . . to be alert to provide such remedies as are necessary to make effective the congressional purpose" (*Borak*, 377 U.S. at 433), and to eliminate "the difficulty of fashioning effective relief . . . before remanding the case so that the trial court may go forward with further proceedings without undue delay." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969).

A. Rescission by Dissolution Is an Available Remedy for a Consummated Merger.

There is nothing in the Acts of Congress or the pronouncements of this Court to support the Seventh Circuit's implication that "unscrambling" is unavailable as an alternate remedy for the material violation of the statute. Congress has declared the consequences of the violation: the merger is "void". Section 29(b), Securities Exchange Act of 1934, U.S.C. §78cc(b)(1934). Pursuing

the enumeration in *Borak* (377 U.S. at 428) of rescission as one appropriate remedy for a merger consummated through a violation of §14(a), this Court in *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 463-64 (1969), found "no reason to emasculate the securities laws by forbidding remedies which might prove to be essential" and ruled that "[o]n remand, the trial court may order a return to the *status quo ante* if it finds that course of action desirable, necessary, and otherwise lawful." These are the questions which the District Court was prepared to consider before the Court of Appeals reversed. In the present posture of the case, the desirability of divestiture remains to be determined, upon an investigation, among other things, of the degree of integration already achieved and the consequences of separation.

In any event, such a decree cannot now be removed from consideration simply because the merger has already been consummated. "Like restitution [divestiture] merely deprives a defendant of the gains from his wrongful conduct. It is an equitable remedy designed in the public interest to undo what could have been prevented had the defendants not outdistanced the [plaintiff] in their unlawful project." *Schine Chain Theatres, Inc.* v. *United States*, 334 U.S. 110, 128 (1948). See also *United States* v. *United Shoe Machinery Corporation*, 391 U.S. 244 (1968). Traditional limits on specific relief, applicable to purely private litigation, must yield when the purpose of giving private rights of action "was not merely to provide private relief, but was to serve as well the high purpose of enforcing the [federal] laws." *Zenith Radio Corporation* v. *Hazeltine Research, Inc.*, 89 S.Ct. 1562, 1580 (May 19, 1969).

In *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F.2d 357 (5th Cir. 1968), *cert. denied* 393 U.S. 913

(1968), the Fifth Circuit, joining the Second,[36] read the voiding provision of Section 29(b) as clear indication that Congress intended a "harsh remedy". There is no novelty in this, for courts of equity, including this Court, have long taught that effective enforcement of conflict-of-interest prohibitions, and particularly the related duty of disclosure, requires harsh remedies, including upsetting transactions in and of themselves completely fair and equitable. *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968); *Mosser* v. *Darrow*, 341 U.S. 267, 274-75 (1951); *Wolf* v. *Weinstein*, 372 U.S. 633, 654 (1963). The right to "disaffirm a contract which is infected by an illegal conflict of interest" is essential because of "this inherent difficulty in detecting corruption . . . ." *United States* v. *Mississippi Valley Generating Co.*, 364 U.S. 520, 565-66 (1961).[37]

B. The Remedy of Monetary Restitution Is Available to Redress a Consummated Merger Authorized Pursuant to Unlawful Proxy Solicitation.

If "unscrambling" should appear, after fair consideration, to be undesirable to the victims of the wrong or inappropriate for other reasons, monetary remedies stand ready as a substitute for specific reparation. Congress charged the courts "to be alert to provide such remedies

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[36] *Goldstein* v. *Groesbeck*, 142 F.2d 422, 426 (2d Cir. 1944).

[37] In shaping a decree of divestiture in accordance with petitioners' prayer (A. 180), the trial court would properly allow for problems of timing and for the rights of third persons, and could include provisions "requiring the respondents to make an accounting of their unlawful gains, and readjusting the equities of the various respondents in whatever companies survived the decree." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969).

as are necessary to make effective the congressional purpose" (*Borak*, 377 U.S. at 433) in *all* cases, not to excuse violations entirely where "unscrambling" may not be warranted.

The equitable remedy of restitution, for the recovery of the value of the benefit conferred by the plaintiff, is traditionally available to afford money relief in transactions tainted by the non-disclosure of conflicting interests. See, *e.g.*, *National Bank & Loan Co.* v. *Petrie*, and *National Bank & Loan Co.* v. *Carr*, 189 U.S. 423 and 426 (1903) (companion cases, per Holmes, J.). This form of relief is specifically afforded by Congress and by this Court in actions under the securities laws. See *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282 (1940). The words of §27 of the 1934 Act, like the counterpart provisions of the 1933 Act, are "entirely sufficient to fashion a remedy to rescind a fraudulent sale [and to] secure restitution . . . ." *Borak*, 377 U.S. at 433. Since the unlawful transaction is treated as annulled when this remedy is invoked, restitution falls squarely within the intention of Congress in declaring the merger contract to be "void" when effected through a violation of the Act. Section 29(b), 15 U.S.C. §78cc(b). The consequent measure of monetary recovery is usually the return to the plaintiff of the value he relinquished, here the value of the corporate interest wrongfully appropriated by the defendant. Since the independent existence of their corporation was unlawfully extinguished, the petitioners are entitled to treat the transaction as an unlawful forced liquidation, and to recover for the minority stockholders their share of the worth of the corporate business at the price it would have brought in a sale, not to the controlling stockholders, but on the open market. *Cf. Sterling*

v. *Mayflower Hotel Corp.*, 33 Del. Ch. 20, 89 A.2d 862 (1952), affirmed 33 Del. Ch. 293, 93 A.2d 107 (1952).

On the other hand, petitioners may choose to accept the valuation placed upon these assets by the respondents themselves. In the opening portions of their proxy statement, they presented a *pro forma* balance sheet for the corporation resulting from the merger, to exemplify the "merit of the merger." A.39. In this document, respondents valued the interest to be acquired from the minority shareholders of Auto-Lite not at the cost of acquisition, but rather at the value attributed to it on Merganthaler's own books. The "minority interests in net assets" of Auto-Lite were represented on Merganthaler's books at $46,757,000 and, at the same time, the value of the preferred stock given in exchange at $34,457,000. The difference inured to the Merganthaler stockholders. In plain terms, respondents represented that the corporate equity acquired from the minority shareholders was worth $12,300,000 more than the minority shareholders were paid for it. A court of equity will hold respondents to their word.

Alternatively, the petitioners may choose, as the measure of money recovery in restitution, the minority's portion of any amounts received by respondents as proceeds of any subsequent sale of the corporate assets which they acquired in the unlawful merger, or the current appreciated value of the assets so acquired,[38] compelling respondents to disgorge their unlawful gains. A plaintiff with "the right to rescind the contract on the

[38] The measure of recovery may embrace the highest market price attained by the wrongfully acquired interest during a reasonable period after the acquisition. See RESTATEMENT, RESTITUTION §151, Comment (c) pp. 600-01 (1936).

ground of fraud [may] follow the property or its proceeds wherever they [can] be found . . . [requiring] that the proceeds of property obtained from it by fraud should be paid to it . . . ." *Montgomery* v. *Bucyrus Machine Works*, 92 U.S. 257, 258 (1875). No matter which of these various measures of recovery petitioners may choose, the trial court is empowered to compel restitution through the issuance of additional securities—partial shares of common stock, preferred stock, or debentures—as a substitute for the direct payment of cash.

None of these measures of recovery involves any inquiry into the fairness of the merger terms. In a different case, a plaintiff's interests might be better served by the measure of damages applicable in a traditional action at law for breach of contract or for the tort of deceit. By bringing such a suit, the plaintiff would ask to be put in the position he would have occupied if the merger had been "fair and equitable" to the minority shareholders (A.31), as it was warranted, and tortiously misrepresented, to be. This expectancy measure of recovery would require a determination of the "fair" exchange, and would involve full litigation of the relative values of two giant corporations, appraised by assets, good will, going concern, market prices, earning ratios, and other evaluation standards, to measure the departure from the limits of legitimate differences in business judgment. The burdens of such a trial would ordinarily prove insuperable, however, for the reasons considered above at pages 56-58 of this Brief. The usual equitable remedy of restitution, by contrast, is unimpeded by any impracticable comparison of values, since it is unrelated to the fraudulent bargain as made. These elementary principles were stated by Mr. Justice Holmes in *National Bank and Loan Co.* v. *Petrie*, 189 U.S. 423, 424-25 (1903):

"The declaration goes upon a rescission of the contract. . . . The right not to be led by fraud to change one's situation is anterior to and independent of the contract. . . . Its usual consequence is that, as between the parties, the one who is defrauded has a right, if possible, to be restored to his former position. . . . [The] fraudulent party, who otherwise might have been allowed to disclaim any different obligation from that with which the other had been content, has lost his right to object, because he has brought about the other's consent by wrong. . . . Here the attempt is to recover outside of it, treating it as set aside. An action for damages caused by fraudulent representations which induced a contract affirms the contract and relies upon it . . . and therefore may be subject to the same defenses as an action brought directly upon the contract . . .[b]ut [not] when a right is claimed to repudiate it. . . ."[9]

Here the petitioners have repudiated the merger, asking for "appropriate orders setting [it] aside" and for an order directing respondents to account to the corporation for the damages sustained by reason of the invalid transfer of corporate assets. A. 180. They do not ask to *enforce* the merger agreement, but to be put in the position they would have occupied if no unlawful merger had been effected. Their right to that relief, unobstructed by any inquiry into "fairness", is "necessary to make effective the congressional purpose". *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433 (1963); *Gerstle* v. *Gamble-Skogmo, Inc.*,

[9] In the companion case, Mr. Justice Holmes upheld the remedy of restitution where the fraud consisted in nondisclosure of the fact that the plaintiff's "confidential adviser" was acting also as agent for the seller, and "that he was on both sides of the transaction and interested against her." *National Bank & Loan Co.* v. *Carr*, 189 U.S. 426 (1903).

C.C.H. Fed. Sec. L. Rep. ¶92,367 (E.D.N.Y. March 7, 1969), quoted *supra*, pp. 55-56.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals for the Seventh Circuit should be reversed, the order of the District Court should be affirmed, and the action should be remanded to the District Court with directions to award such relief as may appear to be appropriate in further proceedings conducted in conformity with the decision of this Court.

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In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 64

ELMER E. MILLS AND LOUIS SUSMAN, PETITIONERS

v.

THE ELECTRIC AUTO-LITE COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's order of April 21, 1969, inviting the views of the United States.

OPINIONS BELOW

The opinion of the district court (App. 675–684)[1] is reported at 281 F. Supp. 826.[2] The opinion of the court of appeals (App. 1001–1014) is reported at 403 F. 2d 429.

[1] "App." references are to the printed Appendix in this Court.

[2] The district court's Findings of Fact and Conclusions of Law upon which summary judgment was granted, its order expunging one of the conclusions of law, and its earlier unreported opinion specifying facts appearing without controversy are set forth at App. 441–454, 684–691.

JURISDICTION

The judgment of the court of appeals was entered on November 25, 1968 (App. 1015). On February 21, 1969, Mr. Justice Marshall extended the time for filing a petition for a writ of certiorari to March 10, 1969. The petition was filed on the latter date, and was granted on April 21, 1969. 394 U.S. 971. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

This brief will discuss the following questions, which it is believed are comprehended by the questions that petitioners present:

1. Whether, in a suit challenging a corporate merger on the ground that the proxies by which the stockholders consented thereto were obtained through materially misleading statements, the fairness of the terms of the merger is a defense to the action or merely bears on the relief to be awarded.

2. Whether a determination that the federal securities laws have been violated by misleading solicitation of proxies required to authorize a corporate merger entitles solicited stockholders, suing as a class and derivatively on behalf of their nonsurviving corporation, to an award of reasonable litigation expenses, past and prospective, irrespective of any other relief that might subsequently be deemed appropriate.

STATUTE AND RULE INVOLVED

Section 14(a) of the Securities Exchange Act of 1934, 48 Stat. 895, as amended, 15 U.S.C. 78n(a), provides:

> (a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 781 of this title.

Section 29(b) of the Securities Exchange Act of 1934, 48 Stat. 903, as amended, 15 U.S.C. 78cc(b), provides in pertinent part:

> (b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation * * *.

Rule 14a–9 of the Securities and Exchange Commission Rules, 17 CFR 240.14a–9, provides in pertinent part:

> (a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading * * *.

STATEMENT

Petitioners are minority shareholders of respondent Electric Auto-Lite Company ("Auto-Lite"). They instituted this action in the United States District Court for the Northern District of Illinois on June 26, 1963, against Auto-Lite and two other corporations, Mergenthaler Linotype Company ("Mergenthaler") and American Manufacturing Company, Inc. ("American"), on behalf of Auto-Lite, derivatively, and on behalf of its minority shareholders as a class. The original complaint sought, *inter alia,* to enjoin the voting of all proxies obtained by the Auto-Lite management in favor of a proposed merger of Auto-Lite and Mergenthaler on the ground that the solicitation of the proxies was materially misleading, in violation of Section 14(a) of the Securities Exchange Act of 1934 ("Act") and the Securities and Exchange Commission's Rule 14a–9 thereunder (App. 3–24). Subsequently, after the merger was authorized at a

meeting of Auto-Lite stockholders and became effective, an amended complaint was filed in February 1964, seeking to have the merger set aside, on the ground, in part, that the proxies solicited by the Auto-Lite management and voted by it to authorize the merger were void because of the violations charged.

The challenged proxy statement proposing the merger of Auto-Lite and Mergenthaler was mailed to the stockholders by the Auto-Lite management on May 29, 1963 (App. 27–134). Before the merger, Mergenthaler owned 54 percent of the outstanding shares of Auto-Lite common stock, and the remaining 46 percent was held by 8,987 other shareholders (App. 1004). Thus, in order to achieve the two-thirds vote required to approve the merger, the votes of minority shareholders holding approximately 13 percent of the outstanding shares were needed. The merger was in fact approved by votes representing 82 percent of the common stock (App. 1005).

The proxy statement consisted of 108 pages. At page 23, under the caption "Principal Holders of Securities," it contained a percentage breakdown of the principal shareholders in the companies involved in the merger. This showed that on May 1, 1963, Gurdon W. Wattles, who was president and a director of American Manufacturing Company, Inc. ("American"), as well as chairman of the board and a director of Mergenthaler and chairman of the executive committee and a director of Auto-Lite, owned approximately 34 percent of the voting stock of American, that American and Mr. Wattles in the aggregate owned approximately 33 percent of the stock of Mer-

genthaler, and that Mergenthaler owned approximately 54 percent of the outstanding common shares of Auto-Lite (App. 51). It was further stated that no other person owned of record, or was known to own beneficially, more than 10 percent of the stock of Mergenthaler or of the common stock of Auto-Lite (App. 51).

On page two of the proxy statement in boldface and larger type than was used generally in the text, was the statement: "The Board of Directors has carefully considered and approved the terms of the merger and recommends that the shareholders vote to approve the plan of merger" (App. 30). On the same page, there appeared in regular type under the heading "Reasons for Merger" the following statement: "After a thorough review of all factors involved, both Boards of Directors are of the opinion that the merger would be mutually beneficial to the Constituent Corporations and their respective shareholders" (App. 30).[3] Mergenthaler's ownership of 54 percent of the Auto-Lite common stock was also mentioned on that page.

Count II of the complaint[4] charged that the sole purpose of the merger was to effectuate a "fraudulent plan" conceived by American and Mergenthaler to

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[3] On page three of the proxy statement, the following explanation appeared in regular type under the heading "Basis of Merger": "The Board of Directors of Electric Autolite believes the plan of merger to be fair and equitable to the shareholders of Electric Autolite; the Board of Directors of Mergenthaler believes the plan of merger to be fair and equitable to the shareholders of Mergenthaler" (App. 31).

[4] Count I of the three-count complaint alleged common law fraud; Count III alleged that the merger was ultra vires under Ohio law (App. 163–177, 180–183).

take over Auto-Lite's business at a loss to Auto-Lite, that no Auto-Lite director was independent and free from the control and domination of Mergenthaler, and that the proxy statement concealed this lack of director independence from the Auto-Lite shareholders (App. 170, 173, 178).

The district court, in an unreported memorandum opinion and order, held that the controlling issue was whether as a matter of law "the proxy statement disclose[d] to the shareholders of Auto-Lite all of the material facts with respect to the control of the Board of Directors of Auto-Lite by Mergenthaler and American Manufacturing so that the shareholders could bring their own independent judgment to bear on the directors' endorsement of their merger proposal" (App. 446–447). It ruled that the proxy statement violated Section 14(a) and Rule 14a–9 because it failed "to disclose * * * that members of the Board of Directors of Auto-Lite were nominees of Mergenthaler" (App. 448).[5] In a subsequent opinion granting, as to Count II of the complaint, the plaintiffs' motion for summary judgment, the court further held that "[w]here the accused proxy material is not merely 'randomly present' in the context of the transaction, a causal relationship is established as intimate and direct, particularly where a merger is involved. * * * Such a direct causal relationship [between the proxy material and the merger] exists in the present case" (App. 681).

[5] The district court subsequently stated that the action taken in that memorandum opinion and order "was a specification of facts appearing without controversy relating to Count II of the amended and supplemental complaint, pursuant to Rule 56(d) of the Federal Rules of Civil Procedure" (App. 464).

The court of appeals agreed that the proxy solicitation material violated Rule 14a-9. It held that "as a matter of law the proxy statement failed, in connection with the advice tendered by the board, adequately to bring out the relationship between the board members [of Auto-Lite] and Mergenthaler. This * * * was an omission of a material fact" (App. 1011). The court further explained that "in light of the [Auto-Lite] board's statements recommending and giving opinions favorable to the merger the failure to give similar emphasis to the relationship with Mergenthaler was the omission of a material fact necessary to make the laudatory statements not misleading" (403 F. 2d at 436).*

The court of appeals disagreed, however, with the district court's holding on the issue of causal relationship, ruling that the granting of summary judgment with respect to this issue was improper because "there is an issue for trial with respect to the causal relationship between the deficiency in the proxy statement and the merger" (App. 1012). The court of appeals stated that because it was too late to prevent the merger "[t]he court must now determine in retrospect whether the unlawful act caused some inequity or damage which the court should relieve or redress";

* The court of appeals pointed out that in the course of a proceeding before the Commission, in which American had sought and obtained an exemption from provisions of the Investment Company Act of 1940 and which was terminated two months before the solicitation of the proxies herein, American had made a statement that tended to show "that the management of American selected directors for Mergenthaler and Autolite, and that Autolite was under the control of American" (App. 1008–1009).

that "evidentiary material tending to show that the merger has merit and the terms were in fact fair and equitable to the minority shareholders * * * does bear on the cause question"; and that, consequently, it may be possible for the defendants "to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found" (App. 1011–1013). The court held that "the burden of persuasion" on the issue of causal relationship would be

> on defendants, who are responsible for the violations, but if they are able to carry the burden, there would be no sound basis for disruption of the merger or other relief. We do not consider that the policy of the '34 act requires the court to unscramble a corporate transaction merely because a violation occurred [App. 1013–1014].[7]

The court of appeals reversed the judgment and ordered that "the costs * * * be taxed in favor of defendants" (App. 1015).

INTRODUCTION AND SUMMARY OF ARGUMENT

Where stockholders have established that a proxy statement sent out to solicit votes to authorize a merger was materially misleading in violation of the Commission's proxy rules, they have proved their cause of action, and it is unnecessary for them to

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[7] The district court had reserved for subsequent determination, pursuant to the recommendations of a master, the issue of appropriate relief (App. 683–684). The court of appeals found the reference to the master inappropriate in the circumstances (App. 1014).

prove, in addition, that the merger would not have been approved if the proxy solicitation had not been misleading.

If such a violation of the proxy rules has been established prior to the corporate meeting at which the proxies were intended to be used, a resolicitation prior to the meeting will normally serve to undo any harm. Where, however, the violation is not discovered until after the meeting [8] or for some other reason preliminary injunctive relief has not been obtained,[9] we agree with the court of appeals that, contrary to the petitioners' contention, proof of the violation does not necessarily require that a merger approved at the meeting through voting of the proxies and subsequently fully consummated must be undone (although such relief is available to the court). A court of equity may properly conclude that, in the circumstances of the case, undoing of the merger would be contrary to the best interests of the parties or of innocent third persons and, therefore, unwarranted. It would normally be necessary, however, to grant other appropriate relief to those who have been harmed by the violation.

Where, as here, the misleading aspect of the proxy solicitation did not relate to the terms of the merger, the stockholders should be entitled to monetary relief only to the extent that they can show they suffered

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[8] Cf. *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432–433.

[9] Preliminary injunctive relief is sometimes conditioned on the plaintiffs' providing a bond, the expense of which may be a deterrent. Cf. *Electronic Specialty Co.* v. *International Controls Corp.*, CCH Fed. Sec. L. Rep. ¶ 92,342 at 97,633 (C.A. 2, January 24, 1969).

pecuniary damages from the merger. If assets and operations of the merged companies have become so intermingled that it is impossible to ascertain whether such injury resulted, the appropriate relief to be accorded, if any, will depend principally on whether the terms of the merger were fair.

The holding of the court below that a showing of "causal relationship" between the proxy violation and the merger is a necessary part of the plaintiffs' cause of action has the unfortunate ancillary effect of denying to stockholder-plaintiffs who can establish a violation of the proxy rules assurance that their reasonable litigation expenses will be reimbursed. Once the violation has been established, the plaintiffs' expenses, both in establishing the violation and in attempting to show unfairness of the merger, should be borne by their corporation; otherwise, private actions under the Commission's proxy rules, which are a necessary supplement to the Commission's enforcement activity, would be seriously inhibited.

ARGUMENT

I. FAIRNESS OF THE MERGER TERMS IS NOT A DEFENSE TO A PRIVATE ACTION COMPLAINING OF MATERIALLY MISLEADING SOLICITATION OF PROXIES WHICH AUTHORIZED A CORPORATE MERGER, BUT IS A RELEVANT CONSIDERATION IN DETERMINING APPROPRIATE RELIEF.

1. Having established a violation of the antifraud provisions of the proxy rules, the plaintiffs should be deemed to have proved their cause of action. *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 433. Thus, as the court of appeals recognized (App. 1011), where a material violation of the proxy rules has been established

before the meeting at which the proxies were intended to be used, courts will enjoin the voting unless there should be resolicitation.[10]

We disagree with the apparent conclusion of the court of appeals that, even where a timely complaint is filed (as was true here), the plaintiffs would have no case, notwithstanding the violation, if the defendants were to show that there probably would have been a sufficient vote to approve the merger had there been no defect in the proxy statement. There are two principal reasons for our disagreement with the court of appeals on this point.

First, it is wholly impracticable to determine directly whether or not the result of the shareholder vote would have been different if the improperly omitted information had been included in the proxy statement. The court of appeals apparently recognized this[11] and focused the inquiry, instead, on the fairness of the merger—based on an apparent assumption that, if the merger were in fact fair, it would have been approved by the shareholders in response to a proper solicitation of their proxies. By thus apparently making the plaintiffs' rights wholly dependent on whether the merger was fair, the decision erroneously insulates a category of proxy violations from private redress. For, no matter how outrageous the misrepresentations in

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[10] *Studebaker Corp.* v. *Gittlin*, 360 F. 2d 692, 698 (C.A. 2); *Willoughby* v. *Port*, 182 F. Supp. 496 (S.D. N.Y.) affirmed as modified *per curiam*, 277 F. 2d 149, 150 (C.A. 2); cf. *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F. 2d 540 (C.A. 2).

[11] It stated that actual "[r]eliance [on the misleading material] by thousands of individuals, as here, can scarcely be inquired into" (App. 1013, n. 10).

the proxy material soliciting votes to approve a merger, the shareholders would have no cause of action if the terms of the merger were found to be fair. Such a result—particularly if carried over to the Commission's enforcement actions, as it seemingly would be if the fairness of the merger were regarded as a defense to a suit for violation of the proxy rules—unjustifiably subverts the proxy rules. Under those rules, shareholders have an independent interest in full and fair disclosure irrespective of the underlying fairness of the merger. They are entitled to receive an accurate proxy statement which is adequate to enable them to exercise their own informed judgment as to the desirability of the merger.[12]

Second, as discussed more fully in Part II, *infra*, there is the practical problem that, if the fairness of the merger were a complete defense, small stockholders would be discouraged by this additional risk in the litigation from attacking allegedly defective proxy statements. This would seriously impede private enforcement of the proxy rules.

Accordingly, we agree with the petitioners that the causation requirement is satisfied if the proxy solicitation itself, rather than the particular defect in the proxy material, was an essential link in the chain of events that brought about the merger. Causation under

[12] Even where the terms of a proposed merger appear to be fair, the outcome necessarily involves uncertainties. The business and operations of the two companies may not fit together as well as was hoped. Shareholders might wish to avoid such risks by voting against a merger unless it appears to them to be affirmatively beneficial rather than merely fair. Moreover, a stockholder may prefer independent operation rather than merger into another company even on a fair basis.

this standard is present here, since some of the votes solicited by the defective proxy material were necessary in order to obtain the required shareholder approval of the merger.[13] In these circumstances, a plaintiff need show only that the defect in the proxy statement was sufficiently material that it might have influenced the vote of a reasonable shareholder.

In the present case, there might well have been stockholders who accepted the advice of their directors in favor of the merger without studying its details, but who would not have accepted that advice without independent study if they had been adequately informed that there was a question as to the disinterestedness of the directors. Since there is no practical way to measure how many votes were affected, the doubt should be resolved in favor of those against whom the violation was directed and for whose protection the statute was designed, rather than in favor of the violators. *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F. 2d 357, 362 (C.A. 5).[14] The objective test suggested above is not only practical and workable but will serve to

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[13] It is unnecessary in this case to resolve the question, presented in *Barnett* v. *Anaconda Company*, 238 F. Supp. 766 (S.D. N.Y.), of causation in the situation where the management has enough votes to approve the transaction, whichever way the minority votes. Even in that situation, however, if it is necessary, for legal or practical reasons, to solicit the proxies of minority shareholders, proxy solicitation could be found sufficiently related to the merger to satisfy the causation requirement. See *Laurenzano* v. *Einbender*, 264 F. Supp. 356 (E.D. N.Y), and the quotation therefrom in n. 14, *infra*.

[14] It has been said that, even where the controlling person has sufficient stock to vote to effect the merger, "[i]t is not * * * to be assumed without evidence that the solicitation of proxies was a gratuitous and, therefore, purposeless and legally

effectuate the underlying purposes of the proxy rules—fair disclosure to shareholders when their votes are solicited.

2. We agree with the court of appeals, however, that the issue of fairness of the terms of the merger may be important—but as relevant to the question of relief, rather than as a complete defense to the cause of action.

It does not follow from the fact that the merger may have been brought about by misleading proxy material that it should necessarily be undone in an attempt to restore the *status quo*. The combined entity is not inherently unlawful, as it would be, for example, if the combination had been found to violate the antitrust laws; and in some instances attempts to unscramble the holdings in the corporate entities could be harmful to innocent third parties (who may have purchased or retained shares in the com-

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inert act." *Laurenzano* v. *Einbender*, *supra*, 264 F. Supp. at 361. The court in that case continued:

> It may be that an unfavorable vote from the minority stockholders would have brought about modification or reconsideration of the transactions; in corporate circles, consensus can be a desideratum. It may be that a value was perceived and sought in just such a favorable vote as was obtained from the one-quarter of the minority stockholders who mailed in their proxies. Such seemingly pointless approbations have their uses, and even the record of disclosure itself may serve a range of useful purposes. * * *

But cf. *Robbins* v. *Banner Industries, Inc.*, CCH Fed. Sec. L. Rep. ¶91,861 at 95,952–95,953 (S.D. N.Y., December 21, 1966), where the court pointed out that "[t]here is no insurer liability under section 14(a); the alleged violation of the proxy rules does not give [rise] to a cause of action under this section unless there is some causal connection between the violation and the injury."

bined entity in reliance on the seemingly valid merger) or, indeed, to the very class of persons who were misled.

Nor do we agree with petitioners' contention that Section 29(b) of the Securities Exchange Act of 1934 (*supra*, p. 3), which declares contracts made or performed in violation of the Act or a rule thereunder to be "void * * * as regards the rights of" the violator and knowing successors in interest, automatically requires that the merger be set aside because the merger agreement is a "void" contract. We recognize that the merger agreement is a "contract made [or performed] in violation of" the Act, and a rule thereunder, within the meaning of Section 29(b), but we believe that, properly interpreted, that Section—which declares such contracts to be "void" only as against the rights of certain persons—basically means that such a contract is voidable at the option of the innocent party thereto rather than necessarily a nullity even if the innocent victim of the violation wishes to enforce his rights under the contract. As the court of appeals for the Eighth Circuit explained in *Greater Iowa Corp.* v. *McLendon*, 378 F. 2d 783, 792:

> * * * Subsection (1) only declares to be void the rights of any person who violates the provisions of the statute. The contract rights of the party not in violation are in no way impaired. Bankers Life and Casualty Company v. Bellanca Corporation, 288 F. 2d 784, 787 (7 Cir. 1961), cert. denied 368 U.S. 827 * * *. Though § 29(b) speaks in terms of "void" and the guilty party is clearly precluded from enforcing the contract against an unwilling innocent party,

> just as clearly the innocent party is left free to enforce the contract if he so desires. This being true the contract cannot possibly be considered absolutely and totally void. It is a contract "voidable" at the option of the innocent party. Royal Air Properties, Inc., v. Smith, 312 F. 2d 210, 213 (9 Cir. 1962). If this contract is "voidable," or void only at the option of the innocent party, the contract must be considered valid until voided by the party having the right of recision. * * *

In the present case, because the plaintiffs are not themselves parties to the merger agreement, they do not enjoy the unqualified statutory right of an innocent party to the contract to have it set aside under Section 29(b) (although, as innocent victims of the proxy violation, they presumably would have the right to rescind their own proxies if they had been submitted in favor of the merger in response to the unlawful solicitation). And, to the extent that the plaintiffs in their representative capacity stand in the shoes of Auto-Lite as a party to the merger agreement, it is far from certain that the shareholders the plaintiffs represent would wish to have the merger set aside. We believe, therefore, that the proper meaning of Section 29(b) in the context of a suit such as the present one is that the contract of merger entered into as a result of the proxy violation is voidable, but should be set aside only if a court of equity concludes, in all the circumstances, that it would be equitable to do so.

It also does not follow from the mere fact of the proxy violation that the stockholders whose proxies were wrongfully solicited are necessarily entitled to

substantial monetary relief, whether or not it might be appropriate for the merger to be undone. If stockholders were misled as to the specific terms of the merger, there should be an accounting so that they would receive that which was represented to them in terms of value. But where, as here, the misleading aspect of the solicitation did not relate to the terms of the merger, the misled stockholders should be entitled to monetary or other relief only if the merger resulted in a reduction to them of earnings or earnings potential. That is, stockholders whose company was merged on the basis of materially misleading proxy solicitations are entitled to recover damages resulting from such merger to the extent that such damages can be shown, as may be possible where assets and operations of the merged companies remain separate. And monetary relief would, of course, be inappropriate where it could be shown that the complaining stockholders were receiving greater earnings or earnings potential than would have been the case had the companies remained separate.

To establish direct injury resulting from the merger in the foregoing manner would normally be impossible in cases in which the assets and operations of the combined companies have been intermingled. A determination of whether the terms of the merger had been fair would then appear to be the proper basis for deciding what relief is warranted. If the merger were found to be unfair at the time it was consummated, it could then be determined what relief would be appropriate to make whole the misled stockholders. Consideration should be given, for example, to attempt-

ing to determine what would have been a fair exchange ratio as contrasted with that involved in the merger, and of awarding minority stockholders whose proxies were wrongfully solicited cash damages or additional stock in the merged company sufficient to make their treatment fair. If, on the other hand, the merger terms were found to have been fair, there would presumably be no damages payable or accounting required to those who have been misled, although in appropriate circumstances injunctive relief might be suitable. These, of course, are questions to be decided by the district court on remand.

II. VIOLATION OF THE COMMISSION'S PROXY RULES SHOULD ENTITLE THE PLAINTIFFS TO AN AWARD OF REASONABLE LITIGATION EXPENSES, INCLUDING ATTORNEYS' FEES, BOTH IN ESTABLISHING THE VIOLATION AND IN ATTEMPTING TO SHOW UNFAIRNESS OF THE MERGER

If, as we have contended, the finding of a proxy violation established the plaintiffs' cause of action, the court of appeals should have affirmed the judgment in plaintiffs' favor, with modification of the district court's reference of the case to a special master, if this was inappropriate. The costs of the appeal would, in that event, have been borne by the defendants.

Similarly, in our view, the plaintiffs, who have established a violation of the securities laws by their corporation and its officials, are entitled to litigation expenses and reasonable attorneys' fees (1) to enable them to go forward with the trial on the issue of appropriate relief and (2) for their efforts in establishing the violation.

Where, as here, prolonged litigation might be required to determine whether a corporation's violation has resulted in unfairness to its stockholders, it is inequitable for the stockholders who have established the violation to be required to bear the expenses of further litigation. It is appropriate, instead, that the corporation (or the entity into which it has merged) bear the expenses of presenting to the court the issue of whether injury resulted and, if so, the determination of proper relief, as well as the expenses that the stockholders have already incurred in order to establish the violation.

The court below held that the burden of persuasion regarding the fairness of the merger has shifted to those shown to have violated the securities laws, but this is scarcely adequate interim relief for the stockholders who have established the violation. Because it is common for corporations planning a merger to hire experts to assess its fairness, it should not be difficult in most cases for the defendants to meet the initial burden by producing the studies and testimony of these experts. The plaintiffs would then be required to offset the evidence of defendants' expert witnesses. This would require them to engage their own expert witnesses, to make audits and investigations of the books and records of the defendants, to take depositions, and to carry on a full-dress trial.

These expenses of proving the plaintiff-stockholders' case are incurred for the benefit of their corporation because there was "deceit practiced on the stockholders as a group." *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432. Certainly, if plaintiffs are able to

show that the plan was unfair to Auto-Lite or its shareholders and that the merger should be dissolved or other relief awarded, there would be a direct financial benefit. Accordingly, plaintiffs' subsequent litigation expenses, including reasonable attorneys' fees (reflecting, among other things, the ultimate benefit, or lack thereof, of the litigation to the corporation or the stockholders as a group), should be borne by their corporation (or the corporation into which it has merged). To eliminate possible abuse, however, it might be appropriate to require the plaintiffs, in order to qualify for reimbursement of their subsequent litigation expenses, to make a preliminary showing of a substantial possibility that the defendants' proof of fairness might be successfully controverted.[15]

For the same reasons, the plaintiffs are even more clearly entitled to reimbursement of their expenses already incurred, including reasonable interim attorneys' fees, in establishing the violation. "[I]n causes like these which involve corporate therapeutics,"[16] attorneys' fees may be awarded notwithstanding the absence of express statutory authorization therefor. For example, in *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 241 (C.A. 2), certiorari denied, 320 U.S. 751, the plaintiff shareholders were awarded attorneys' fees for their recovery of short-swing profits under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), even though recovery of attorneys'

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[15] Cf. *Dolgow* v. *Anderson*, 43 F.R.D. 472, 501–503 (E.D. N.Y.).

[16] *Murphy* v. *North American Light and Power Co.*, 33 F. Supp. 567, 570 (S.D. N.Y.).

fees is not expressely provided for in Section 16(b) and is expressly provided for in two unrelated sections of the same statute.[17] The court relied on the long recognized principle that "a stockholder who is successful in maintaining * * * an action [for his corporation's benefit which it has been unwilling to institute] is entitled to reimbursement for reasonable attorney's fees on the theory that the corporation which has received the benefit of the attorney's services should pay the reasonable value thereof." 136 F. 2d at 241.[18]

Award of attorneys' fees has been deemed appropriate even where no fund at all may be produced by the litigation. For example, in reorganization cases under Chapter X of the Bankruptcy Act, 11 U.S.C. 501, *et seq.*, attorneys' fees are awarded for various activities considered beneficial to the debtor's estate, such as opposition to a plan not meeting the statutory standards.[19]

If "benefit" to the corporation be the test of whether it is equitable to award attorneys' fees, benefit must

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[17] See Sections 9(e) and 18(a) of the Securities Exchange Act, 15 U.S.C. 78i(e) and 78r(a), respectively.

[18] See, generally, *Trustees* v. *Greenough*, 105 U.S. 527; *Sprague* v. *Ticonic National Bank*, 307 U.S. 161. See, also, *Maggiore* v. *Bradford*, 310 F. 2d 519 (C.A. 6); cases cited in Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 Harv. L. Rev. 658, 675–679; and in Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 Colum. L. Rev. 1, 24–28. Cf. *Bakery and Confectionary International Union* v. *Ratner*, 335 F. 2d 691 (C.A. D.C.).

[19] See Sections 241–246, 248 and 249 of the Bankruptcy Act, 11 U.S.C. 641–646, 648 and 649, respectively; 6A Collier, *Bankruptcy* ¶ 13.02 at 914–915, ¶ 13.06 at 954, ¶ 13.12 at 981, ¶ 13.14 at 994 nn. 14, 15 (14th ed. 1968). See, *e.g.*, *Scribner & Miller* v. *Conway*, 238 F. 2d 905, 907 (C.A. 2); *In re Consolidated*

be calculated in the light of the statutory policy requiring fair disclosure in the solicitation of proxies. If, for example, it had been feasible to try the issue of violation in the present case prior to the meeting at which the votes were cast, the plaintiffs surely would have been entitled to attorneys' fees even if the stockholders later voted to approve the merger after a proper resolicitation of their proxies. The fact that, as we urged in point I, it may no longer be practical or equitable to set aside the merger does not compel denial of a fee; the stockholders will here be benefited by obtaining judicial scrutiny of the fairness of the plan as a substitute for a properly informed vote of the stockholders.

This Court has noted that "Private enforcement of the proxy rules provides a necessary supplement to Commission action." *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432; cf. *Smolowe* v. *Delendo Corp., supra,* 136 F. 2d at 241; *Blau* v. *Rayette-Faberge, Inc.,* 389 F. 2d 469, 472 (C. A. 2); *Gilson* v. *Chock Full O'Nuts Corp.,* 331 F. 2d 107, 110 (C.A. 2). It provides an important deterent to unlawful proxy solicitation by corporate management. Such enforcement will be dis-

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Motor Parts, Inc., 85 F. 2d 579, 581 (C.A. 2); *In re Midland United Co.*, 64 F. Supp. 399, 410 (D. Del.), affirmed on other grounds, 159 F. 2d 340 (C.A. 3). Cf. *Abrams* v. *Textile Realty Corp.*, 97 N.Y.S. 2d 492, 496 (Sup. Ct.):

> [O]n the narrow issue of law as to "the right" to an allowance [of attorney's fees], * * * there is no relevance in an argument that this suit created no fund or property for [the defendant corporation] or its security holders, or that they or any of them would have been better off if the *ultra vires* act had been performed. The law cannot refuse to recognize as beneficial full observance of the law.

couraged if interim relief such as suggested herein is unavailable after a violation has been established. The court in *Smolowe, supra,* 136 F. 2d at 241, noted that the "possibility of recovering attorney's fees" may "provide the sole stimulus" for a shareholder to initiate an action challenging questionable corporate activities. And a perceptive commentator summed up the need for reimbursement of litigation expenses as follows:[20]

> If reimbursement were not permitted to a stockholder successfully prosecuting a suit to redress a wrong to his corporation, the practical effect would be the same as if the suits were prohibited and the small stockholder remediless, for the expenses in most cases would exceed the increase in the value of his stock, resulting in a net loss to him individually even if he were successful in recovering for the corporation. * * *

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[20] Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 Colum. L. Rev. 784, 791. See, also, Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 Harv. L. Rev. 658, 663.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be modified in accordance with the views expressed in this brief.

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In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 64

ELMER E. MILLS and LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Respondents' Brief

QUESTIONS PRESENTED

The questions presented for review by this Court are:

1. Whether a merger proxy statement is materially misleading where all necessary disclosures are contained within the document, but the recommendation of the board of directors that the merger be approved is set forth in boldfaced type.

2. Whether a finding that a proxy statement should have been phrased differently establishes the right to summary judgment, without giving consideration, as required by Proxy Rule 14a-9, to the circumstances under which the statement was made.

3. Whether shareholders would be better protected by a rule requiring persons having knowledge of defects in proxy material to take prompt action or by a rule, as suggested by the government, imposing automatic liability without regard to diligence in prosecuting claims.

4. Whether the finding of a defect in a proxy statement requires the voiding of a consummated transaction and the unwinding of a merger, irrespective of the effect of such relief on the interests of the shareholders.

STATEMENT OF THE CASE

Because the facts and circumstances surrounding the merger transaction have not been adequately presented and because the facts are crucial to a resolution of this case, we summarize them below.

Facts And Circumstances Surrounding The Merger

On June 4, 1963, The Electric Auto-Lite Company ("Auto-Lite") mailed to its shareholders a proxy statement and notice of a special shareholder meeting, scheduled for June 27th, for the stated purpose of voting upon a proposed merger of Auto-Lite into Mergenthaler Linotype Company ("Mergenthaler"). (A. 27-134, 476.)

The merger arose in the following context.

Auto-Lite's position in a changing market.

As the proxy statement explained, Auto-Lite had been principally engaged in the manufacture and sale of automotive parts and equipment. (A. 51.) Its sales volume and profits were tied to and reflected the fluctuating automotive market. (A. 42, 52.) In addition, Auto-Lite's market position was threatened by a growing trend on the part of the "big three" to manufacture their own parts necessary in the production of new cars. They also began distributing replacement parts for other makes of cars in addition to their own. Auto-Lite's own customers were emerging as its competitors. (A. 394-96, 596.)

In 1960, Chrysler Corporation, for many years Auto-Lite's principal customer, began making major electrical parts which it had previously bought from Auto-Lite. Auto-Lite's sales to Chrysler declined from 35% of total sales in 1958 to 12% in 1962. (A. 53.)

In light of these adverse competitive conditions, the company in 1961 sold the "Auto-Lite" trademark together with most of its distribution organization for replacement parts to Ford Motor Company. (A. 56.)

Mergenthaler—54% shareholder of Auto-Lite.

As the proxy statement disclosed, Mergenthaler had begun to purchase Auto-Lite stock in 1957. By 1963 Mergenthaler owned a controlling interest, 54% of the outstanding shares, and Auto-Lite had become its "consolidated subsidiary." (A. 30, 32, 34, 51, 76.)

Mergenthaler had for many years been the leader in the production of linotype machines and had an established reputation in the graphic arts field. Unlike Auto-Lite, Mergenthaler operated within a stable industry. (A. 61-62.)

Business reasons for the merger.

Mergenthaler had a world-wide network of distributors with offices in 111 countries and territories and could use its position in the foreign market to develop Auto-Lite's international sales in the automotive equipment field. (A. 30, 62.) Auto-Lite's position in the equipment leasing field would be advantageous to Mergenthaler in leasing graphic arts products. (A. 30.) The combined companies could be more efficiently operated and effectively administered under unified management and would provide the shareholders with a greater degree of balance and diversification. (A. 30.) The merger thus made good economic sense.

Immediately prior to the merger, Auto-Lite had the lowest profit to asset ratio of 22 leading auto parts manufacturers. (A. 621-22, 627.) The Auto-Lite board was advised by independent consultants that: ". . . the merged company, by combining its talents, may help [Auto

Lite] to expand its automotive business in foreign markets and to diversify into new products where the rate of earnings on sales is higher than that now experienced." (A. 625.)

Fairness Of The Merger Terms To The Minority Auto-Lite Shareholders

Mergenthaler proposed to merge at an exchange ratio which would give the minority Auto-Lite shareholders a premium. (A. 560-63, 610-11.) In order to obtain an independent analysis of the merger terms, the Auto-Lite board retained Standard Research Consultants, Inc., a division of Standard and Poor's Corporation. Standard Research advised the board that the stock to be received in the merger exchange would be "worth more on an intrinsic investment basis" than the value of the Auto-Lite stock surrendered and that the merger ratio was "fair and equitable and in the best interests" of the minority Auto-Lite shareholders. (A. 591, 611.)[1]

Based upon this advice and their own knowledge of the company, the Auto-Lite directors approved the merger. They took this action in the belief, subsequently confirmed by the market price of the stock of the merged company, that the merger would benefit the corporation and its shareholders. (A. 652-74.)

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[1] Standard Research's conclusion was based on the following factors, among others: (1) the Auto-Lite shareholders would receive convertible preferred stock with increased dividends in the merged corporation; (2) Auto-Lite's stock was vulnerable and had a "pronounced downside risk potential" because of the company's inferior profit performance; and (3) the conversion privilege of the preferred stock presented a good capital gain opportunity. (A. 611.)

Disclosures Contained In The Proxy Statement

The proxy statement contained an exhaustive and accurate financial description of the two companies and the terms of the proposed merger. (A. 34-93.)

Because the court rulings below turned upon the manner of the disclosure of the relationship between Auto-Lite and Mergenthaler, we list below the disclosures made on this issue:

1. Mergenthaler owned 54% of the Auto-Lite stock and intended to vote its stock in favor of the merger. Mergenthaler's controlling interest in Auto-Lite was set forth both in terms of the total number of shares owned and on a percentage basis. (A. 30, 51.)[2]

2. Since 1962 Auto-Lite had been a "consolidated subsidiary" of Mergenthaler. This fact was referred to throughout the proxy statement. (A. 34, 35, 38, 39, 61, 63, 65, 71, 74, 76, 77, 78, 79, 81.)

3. Mergenthaler and Auto-Lite for some time had four common directors—Mr. Pulleyn since 1962, Messrs. Keller and McAlpin since 1960, and Mr. Wattles since 1957. Three pages in the proxy statement were devoted to this subject. This information was set forth both in tabular and textual form. (A. 49-51.)

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[2] Mergenthaler's controlling stock interest in Auto-Lite was no surprise to the Auto-Lite shareholders. In 1962, Mergenthaler had obtained majority control by a voluntary exchange offer to the Auto-Lite shareholders. (A. 32, 44, 57, 76.) In the exchange offer, the Auto-Lite shareholders were informed that: "Mergenthaler's ownership in [Auto-Lite] is now of such significant proportions that Mergenthaler believes it desirable to acquire a majority interest in [Auto-Lite] in order to obtain the benefits accruing to a majority stockholder."

4. American Manufacturing Company ("American") and its President, Gurdon W. Wattles, owned 33.41% of Mergenthaler stock and no person other than Mergenthaler owned more than 10% of the stock of Auto-Lite. (A. 51.)

5. Four directors of Mergenthaler, including Messrs. Pulleyn and Wattles, had been officers, directors and shareholders of American. Mr. Wattles was simultaneously Chairman of the Executive Committee of Auto-Lite, Chairman of the Board of Mergenthaler and President of American. (A. 51.)

6. Mergenthaler had "majority control" of and a "controlling stock interest" in Auto-Lite. (A. 34, 76.)

On page 2 of the proxy statement, three sentences after the disclosure that Mergenthaler owned 54% of Auto-Lite and intended to vote in favor of the merger, the shareholders were told in a single boldfaced sentence that the Auto-Lite board recommended approval of the merger. (A. 30.)

Petitioners' Failure To Seek Prompt Corrective Relief

Three weeks before the scheduled shareholder meeting, petitioners (owners of 600 of 1,160,565 outstanding Auto-Lite shares) received their copies of the proxy statement. (A. 809, 864-65.) Petitioners immediately retained counsel experienced in securities litigation. (A. 804-05, 813-15, 816, 862.) "Several weeks" before the scheduled shareholder meeting, it was decided that a lawsuit would be filed. (A. 829.)

Petitioners waited until 49 minutes before the close of business on June 26, 1963, the day before the scheduled shareholder meeting, to file their complaint. Suing deriv-

atively and on behalf of all Auto-Lite shareholders—not one of whom has joined their litigation—petitioners contended that the proposed merger and the proxy material distributed in connection with it violated both state law and Rule 14a-9 promulgated under Section 14(a) of the Securities Exchange Act. 15 U.S.C. § 78n(a) (1964); 17 C.F.R. 240.14a-9. Paragraph 10 of their complaint specifically objected to the use of boldfaced type in setting forth the directors' recommendation. They also complained that the control relationship between Auto-Lite and Mergenthaler was inadequately disclosed. (A. 7-8.)

Petitioners did not notify Auto-Lite management of their objections prior to the shareholder meeting. (A. 829.) They did not request that management correct any alleged errors in the proxy material. They did not seek to have the meeting postponed so that they might distribute their own material. They did not seek redress from the staff of the Securities and Exchange Commission ("SEC"). And they did not seek a judicial postponement of the shareholder meeting. The Auto-Lite management did not receive actual notice of the filing of the suit until after the shareholder meeting. The decision not to seek a temporary restraining order was made deliberately, for tactical reasons, and not for want of time. Counsel for petitioners informed the District Court that it was his experience as counsel in securities cases which led him deliberately to avoid seeking preliminary relief. (A. 832.)

At the shareholder meeting, over 5,000 minority Auto-Lite shareholders returned proxies. Approximately 96% of the shareholders voting favored the merger. (A. 476-77, 1012.)

The District Court's Disposition Of This Case By Summary Judgment

In May, 1965, two years after filing their complaint, petitioners moved for summary judgment as to part of Count II, which charged a federal securities violation.[3] They attached to the motion material relating to an Investment Company Act proceeding held before the SEC in which American obtained an exemption from the Act on the finding that it controlled Mergenthaler and, through it, Auto-Lite.[4] These proceedings referred to a fact never disputed, that Mergenthaler was in a control relationship to Auto-Lite. Based upon this material, petitioners claimed that the proxy statement did not adequately disclose Mergenthaler's "control" over Auto-Lite. (A. 210-12.)

Respondents contended that a complete disclosure of the relationship between the corporations had been made in the proxy statement. In response to petitioners' charge that the Auto-Lite board acted against the best interests of the Auto-Lite shareholders, respondents submitted affidavits of every Auto-Lite director, each stating that he

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[3] Count I of the complaint charged common-law fraud. (A. 163-77.) Count III alleged that the merger was *ultra vires* under Ohio law. (A. 180-83.)

[4] In March, 1963, the SEC entered a published opinion and order (41 S.E.C. 415; Invest. Co. Act Release No. 3649), finding that American, through Mergenthaler's majority stock ownership, "controlled" Auto-Lite as that term is defined under the Investment Company Act. (A. 418-30.) Under the Act, any company which owns more than 25% of the voting stock of another company is "presumed to control such company." 15 U.S.C. § 80a-2(a)(9) (1964). Two months later, the SEC reviewed and cleared the Auto-Lite proxy statement involved here.

had exercised his independent judgment in analyzing and approving the merger and that the terms were not dictated to him by Mergenthaler or American. (A. 652-74.)

On November 15, 1965, the District Court granted petitioners' motion for partial summary judgment. (A. 441-54.) The court made no finding that the extensive financial and background information relating to the terms of the merger was in any way incorrect. The court did find, however, that the proxy statement did not adequately reveal the "control" relationship between Auto-Lite and Mergenthaler. Over respondents' objections, the case was referred to a Master to determine relief. (A. 456-59, 723-25.)

On February 14, 1966, the District Court held that its prior opinion was not a summary judgment ruling, but a "specification of facts appearing without controversy" pursuant to Rule 56(d). (A. 464.) The court held that it was required to "determine whether there was a causal connection between the finding that there has been a violation of the disclosure requirements of §14(a) and the alleged injury to the plaintiffs. . . ." (A. 463.) On June 16, 1966, it set the matter for trial, ruling that it could not decide the case until it had obtained a "complete view of the entire transaction." (A. 472, 889.)

On July 12, 1967, petitioners moved for "supplemental" summary judgment, asserting that they had established the requisite causal relationship by showing a point never contested: that some votes obtained through the proxy solicitation were necessary to achieve two-thirds approval of the merger. (A. 522-24.)

In opposition to petitioners' motion, respondents resubmitted the directors' affidavits (A. 652-74) as well as the Standard Research studies described in the proxy statement. (A. 568-639.) Respondents also submitted the affi-

davit of Professor James H. Lorie of the University of Chicago Business School and Director of the Center For Research In Securities Prices, who appraised the value of the Auto-Lite stock to determine the fairness of the merger terms. (A. 560-63.) On the basis of a formula widely used in the financial community, he concluded that the merger exchange ratio was fair to the Auto-Lite shareholders since "the value received . . . was in excess of the intrinsic value or inherent worth of the Auto-Lite stock surrendered." (A. 563.)

Respondents submitted affidavits of representative Auto-Lite shareholders who stated that they understood the control relationship existing between Mergenthaler and Auto-Lite, that they were not misled, and that they believed the terms were fair and beneficial and wanted the merger to stand. (A. 644-51.)

None of the material filed in opposition to the summary judgment motion was controverted by petitioners.

The District Court granted "supplemental" summary judgment as to liability on Count II on September 26, 1967. It held that a causal relationship had been established because

> "the areas of industrial activity linked by the merger are so inherently unrelated as to cause the new corporation to fall in that category of business enterprises as referred to recently by the Supreme Court as constituting a conglomerate merger, and to be inherently dangerous to a healthy economy." (A. 682-83.)

No party argued in support of this theory in either court below.[5] Nor do petitioners or the government as amicus raise it here.

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[5] The court's antitrust ruling was unexpected: ". . . I have finally come up with a determination of what the Supreme Court [in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964)] had in mind. . . . It is not what any of us have been thinking about at all." (A. 909.)

As it had done in its previous 1965 summary judgment order, the District Court referred the matter to a Master with broad powers to determine appropriate relief. (A. 683-84.)

Opinion Of The Court Of Appeals

The Court of Appeals reversed the summary judgment order and remanded the case for trial on the question of liability. It held that the proxy statement should have been phrased differently, but ruled that the District Court should inquire whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." (A. 1013.)

With respect to the deficiency, the Court of Appeals viewed the matter as one solely of emphasis, the use of boldfaced type to express the board's recommendation being decisive. The court said:

> "Had the proxy statement simply reported approval, without emphasis and along with the other facts, we might have a different situation." (A. 1009.)

It held

> "as a matter of law that in the light of the board's statements recommending and giving opinions favorable to the merger with failure to give similar emphasis to the relationship with Mergenthaler was the omission of a material fact necessary to make the laudatory statements not misleading." (A. 1014.)

The court conceded that "several facts pertinent to the relationship between the eleven members of the Auto-Lite board and Mergenthaler do appear in portions of the proxy statement" (A. 1006) and that:

> "[T]he proxy statement contains information which would indicate to those aware of corporate mechanism that Mergenthaler had the power to select a majority,

> if not all, the members of the [Auto-Lite] board, may well have exercised it, and that a minority, at least, were directors of both [Auto-Lite and Mergenthaler]." (A. 1007.)

The Court of Appeals held that respondents would have the burden of proving "by a preponderance of probabilities" that the merger would have been approved even had there not been misplaced emphasis in the proxy statement. The court also stated that the question of fairness of the merger "does bear on the cause question." (A. 1012-13.)

SUMMARY OF ARGUMENT

The Court of Appeals erred in concluding that the merger proxy statement was defective because it used boldfaced type to set forth the recommendation of the Auto-Lite board that the merger be approved without giving "similar emphasis" to the relationship between Mergenthaler and Auto-Lite. This relationship was spelled out in a variety of ways, so that no shareholder could help but have known of its existence. Immediately preceding the board's recommendation, the shareholders were told that Mergenthaler owned 54% of Auto-Lite's stock and intended to vote in favor of the merger. The proxy statement went on to disclose that Mergenthaler held a "majority" and "controlling" interest in Auto-Lite, that no other shareholder owned more than 10% of the Auto-Lite stock, that the directors of Auto-Lite and Mergenthaler were interlocking, and that Auto-Lite had been treated as a "consolidated subsidiary" of Mergenthaler. Significantly, the SEC, which reviewed and cleared the proxy statement, had full knowledge of the use of boldfaced type setting

forth the board's recommendation, and had only two months earlier completed extensive proceedings involving the very control relationships now alleged to have been under-emphasized.

In any event, as the Court of Appeals properly held, it would be impermissible to impose liability without trial solely on the basis of a misplaced emphasis in the proxy statement, and without inquiry into the facts and circumstances surrounding the merger. Respondents are entitled to their day in court. Rule 14a-9 requires that an alleged omission be judged "in light of the circumstances under which it is made. . . ." Liability can only be imposed upon consideration of circumstances such as the gravity of the alleged omission, the nature of the matter under consideration, petitioners' deliberate decision not to seek preliminary relief, and the fairness of the merger. The merger terms were fair, and, as the government concedes, the alleged deficiency did not pertain to those terms.

Moreover, considerations of policy will not support a rule applied to consummated transactions which imposes automatic liability without trial merely on a showing that a proxy statement should have been phrased differently. This rule may be proper where an injunction is sought prior to the shareholder vote. Then courts need not inquire into circumstances such as fairness or make retrospective judgments as to the effect of a defective statement on the vote. Where the transaction has been completed, the procedure adopted by the Court of Appeals affords the only proper solution by placing the burden of proof on respondents to show that the defect did not have an effect on the vote. A contrary rule as suggested by the government, which

automatically imposes liability in all cases without trial, would not provide an impetus to prompt action on the part of claimants.

Certainly, fees and costs should be awarded only to diligent shareholders whose action has benefited the corporation. The government's suggestion of an interim fee award in all cases would encourage parties with knowledge of defects in proxy material to defer assertion of claims until it is too late for the corporation to take corrective action. Corporate suffrage is better served by a rule which allows the correction of proxy material prior to the shareholder vote.

Finally, there is no support for petitioners' assertion that a defect in a proxy statement requires voiding the transaction and retrospectively unwinding the merger. Petitioners take the extreme position that there can be no inquiry into the fairness of the merger terms. Their position would cause great hardship to innocent third parties and to the very shareholders whom petitioners purport to represent. Respondents agree with the government that such a Draconian approach to remedies is ill-founded.

ARGUMENT

I.

THE PROXY STATEMENT MADE A FULL AND FAIR DISCLOSURE OF THE RELATIONSHIP BETWEEN AUTO-LITE AND MERGENTHALER.

The Auto-Lite shareholders were more than adequately advised of the relationship between the respondent companies. The proxy statement disclosed on page two that:

> "Mergenthaler, which owns approximately 54% of the outstanding shares of Electric Autolite, intends to vote in favor of approval of the Agreement of Merger." (A. 30.)

It was only following this disclosure that the Auto-Lite board stated its recommendation in boldfaced type that the merger be approved. The immediate and clear attention given to Mergenthaler's majority position and intention to vote in favor of the merger was by itself sufficient to cause any minority shareholder to scrutinize the merger terms carefully. The proxy statement went on, however, and in explicit, complete and repetitious terms spelled out Mergenthaler's controlling stock interest in Auto-Lite and the relationship between the boards of the two companies.

The shareholders were repeatedly informed under appropriate, carefully indexed headings that Mergenthaler had a 54% interest in Auto-Lite; that American had a 33% interest in Mergenthaler; that no one else owned more than 10% of either Mergenthaler or Auto-Lite; that the directors of the two companies were interlocking; that all the Auto-Lite directors, including those who were not common to the Mergenthaler board, would serve on the

board of the surviving corporation; that Mergenthaler controlled Auto-Lite and in turn was controlled by American; that Auto-Lite was Mergenthaler's "consolidated subsidiary"; and that Mergenthaler as majority shareholder in Auto-Lite intended to vote in favor of the merger. (A. 30, 34, 38, 39, 49-51, 61, 63, 65, 71, 74, 76, 77, 78, 79, 81.)

The proxy statement thus fully met the criterion thought to be relevant by the Court of Appeals: "whether the minority shareholders were sufficiently alerted to the board's relationship to their adversary to be on their guard." (A. 1009.) A proxy violation cannot be posited on the unwarranted assumption that the Auto-Lite shareholders read the sentence set forth in boldfaced type on page two, upon which the Court of Appeals focused, and ignored all other disclosures, including the material which immediately preceded the board's recommendation. Any reasonable reading of the proxy statement would disclose to the Auto-Lite shareholder that—in the Court of Appeals' words—his "adversary" was in a control relationship to Auto-Lite. (A. 1009.)

Auto-Lite cannot be faulted, as the Court of Appeals would have it (A. 1007), for placing some of the information concerning its relationship to Mergenthaler later in the proxy statement than the board's recommendation of the merger. The intervening information, which contained detailed financial facts concerning the companies and the proposed merger, was critical material for any shareholder who wanted to make an informed judgment on the primary question before him—whether the merger would benefit his investment interest. Further, inclusion of this information is specifically required by SEC Regulations. Items 14 and 15, Schedule 14A (17 C.F.R. 240.14a-101).

Significantly, when the SEC reviewed and cleared the proxy statement prior to its distribution to the Auto-Lite

shareholders, it was fully aware of all the facts relied upon by the Court of Appeals in finding the existence of a violation: (1) that boldfaced type was used to express the board's recommendation of the merger, and (2) that certain of the facts relating to the control relationship between Auto-Lite and Mergenthaler were set forth in a subsequent portion of the proxy statement. This control relationship had been the subject of extensive public hearings before the SEC. As a result of these hearings, approximately two months prior to clearance of the Auto-Lite proxy statement, the full Commission had issued an order exempting American from the provisions of the Investment Company Act. 41 S.E.C. 415.[6]

While the clearing of the proxy statement by the Commission is not to be taken as its imprimatur, "some force" must be given to the clearance "in a case such as this where the omissions were of facts well known to it." *General Time Corp.* v. *Talley Indus., Inc.*, 403 F.2d 159, 163 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969).[7] See also SEC brief (p. 25) in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), and this Court's opinion there. 377 U.S. at 432.

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[6] The SEC staff made suggestions concerning the content of the proxy statement and requested certain changes which were adopted. The SEC was particularly interested in Mergenthaler's controlling relationship to Auto-Lite, since that relationship was directly pertinent to accounting principles such as "pooling of interests" used in the proxy statement. (A. 32.) The SEC did not request that the boldfaced type be eliminated nor did it request that the disclosures of the controlling relationship be stated differently.

[7] In *General Time*, the alleged deficiency was based upon the failure to refer to certain proceedings under the Investment Company Act. The court specifically gave "some force" to the SEC's clearance of the proxy statement since it had knowledge of those proceedings. 403 F. 2d at 163.

The Auto-Lite proxy statement was in full conformity with the Commission's Rules. It emphasized all relevant facts with respect to the relationship between Auto-Lite and Mergenthaler by repeatedly placing them throughout the proxy statement in both narrative and tabular form. The courts below thus erred in concluding that, as a matter of law, the proxy statement was misleading.

II.

SUMMARY JUDGMENT OF LIABILITY SHOULD NOT BE GRANTED WITHOUT CONSIDERING THE CIRCUMSTANCES SURROUNDING THE CHALLENGED TRANSACTION.

SEC Rule 14a-9 prohibits the issuance of proxy material

> "... *which, at the time and in the light of the circumstances under which it is made,* is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading." 17 C.F.R. 240.14a-9. (Emphasis added.)

Despite the clear language of this Rule, respondents have not yet had a hearing as to the circumstances under which the statements contained in the proxy material were made. It is for this reason that the Court of Appeals reversed the summary judgment ruling of the District Court and remanded this case for trial. Petitioners and the government seek affirmance of the District Court's summary judgment of liability. They would deny respondents their day in court on the very issues which must be resolved under the Rule as prerequisite to a finding of liability.

A.

No Finding Of Liability Can Be Made Until The Alleged Defect Is Judged In Light Of The Relevant Circumstances.

All relevant circumstances must be considered in determining whether respondents should be held liable for a violation of the Proxy Rules. Among the considerations which would be developed at trial are: the gravity of the omission; the nature of the matter being voted upon; the percentage of the vote needed and received; the interests of innocent third parties; the attractiveness of the merger; and the stage of transaction at which relief is sought (whether pre-vote or post-vote). As we will show, none of these considerations here warrant the imposition of liability in absence of trial.

The omission alleged here is not of major import. The government's brief assumes for the purpose of argument that the Auto-Lite proxy statement, which it had previously cleared, should have been phrased differently. It concedes, however, that this assumed defect ". . . did not relate to the terms of the merger." (Gov't Br., pp. 10, 18.)

Although petitioners sprinkle their brief with epithets such as "fraud" and "conflict of interest" (pp. 10, 13, 19, 27, 28, 36-38, 41-43, 48, 51-55, 59, 65, 66, 68, 69), such issues cannot be resolved against respondents on this record. No fraud or breach of fiduciary duty has been shown, and, indeed, such charges have been affirmatively denied. (A. 652-74.) The deficiency found was a misplaced emphasis—not an affirmative concealment or a knowing misstatement of material fact.

The prime question the minority Auto-Lite shareholders were voting upon was whether the merger would benefit their investment interests. The extensive financial and business details contained in the 108-page proxy statement have not been found to be in any way incorrect.

In addition to Mergenthaler's 54% holding, the percentage of outstanding shareholder votes needed to secure approval of the merger was relatively small—only 13%. The Auto-Lite shareholders overwhelmingly approved the merger terms, which were scrupulously and accurately described in the proxy statement. Petitioners themselves admit they were not misled when they voted against the merger. (A. 821, 865.) Since, as the Court of Appeals noted, "nothing in the record indicates dissatisfaction with the merger on the part of any shareholders who voted for it" (A. 1012), it would strain credulity to hold as a matter of law that the vote would have been different had the proxy statement omitted the use of boldfaced type.

Any imposition of liability in this case must be viewed in light of its effect on the intervening interests of third parties. In the more than six years since the merger, thousands of shares in the merged corporation, now called "Eltra," have changed hands. There are 15,643 Eltra shareholders. Of those, over 7,000 have become shareholders since the merger. Professor Loss states that a plaintiff's burden of establishing a violation of the proxy rules should become "increasingly difficult . . . when the rights of innocent third parties have intervened." 2 L. Loss, *Securities Regulation* 961-62 (2d ed. 1961).[8]

[8] Significantly, none of the cases cited by petitioners in support of automatic liability involved innocent third parties. Those cases involved gross fraud, and the relief was directed against wrongdoers only. In *SEC* v. *Capital Gains Research Bureau, Inc.*,

The Court of Appeals correctly decided that one factor which would "bear" directly on the question of liability is the "fairness" of the proposed merger—the very question the shareholders were voting upon. There is no basis for the government's statement that the court's opinion sets up fairness as a "complete defense." (Gov't Br., p. 13.) All the Court of Appeals directed, and all that respondents ask, is that the trier of fact examine the fairness of the merger together with all other circumstances as required by Rule 14a-9.

Even a cursory view of the circumstances surrounding the merger indicates why the Auto-Lite shareholders considered the merger to be attractive. Facts disclosed in the proxy statement, such as Auto-Lite's dependence on the fluctuating automotive market, its loss of considerable Chrysler business, and Auto-Lite's low earnings, must have formed part of the decision of the Auto-Lite shareholder who voted to approve the merger. He was given convertible preferred stock guaranteeing a larger dividend than he received as an Auto-Lite shareholder, a fixed return in the case of declining earnings, and the option of realizing equity appreciation by converting to common stock in a combined company that would have more market appeal—an option which nearly all the shareholders have exercised.

(footnote continued)

375 U.S. 180 (1963), this Court was called upon to consider the imposition of a "mild prophylactic," enjoining investment counselors from refusing to disclose their unfair practice of "scalping" in future transactions. 375 U.S. at 193. *Wolf* v. *Weinstein*, 372 U.S. 633 (1963), imposed the highest standards of conduct upon any "persons performing fiduciary functions" (insiders) in bankruptcy reorganizations. The court in *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F.2d 357 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968), was concerned with a single bond sale effected by an unregistered dealer of securities with respect to a single customer. The court there expressly limited its holding, and the relief given, to two-party transactions. 391 F.2d at 363.

Professor James Lorie's independent financial analysis establishes that the Auto-Lite minority shareholders received more than the fair value of their Auto-Lite stock in the merger exchange. (A. 560-63.)[9] Indeed, the wisdom of their vote approving the merger has been borne out by the market, since their investment has substantially increased.

An additional factor present in this case is petitioners' deliberate delay in seeking corrective relief. Since an alleged deficiency in a proxy statement can easily be corrected if called to the attention of management, the SEC or a court, the possible salutary effect of petitioners' suit was lost when they elected not to advise anyone of their objections prior to the shareholder vote.[10] Where a shareholder deliberately waits until the last minute before seek-

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[9] While petitioners contend that fairness is irrelevant, they assert that the merger resulted in a $12 million loss to the shareholders. (Br., pp. 5, 67.) This contention is based on an absurd comparison between *book* value of the Auto-Lite stock exchanged and the *par* value of the convertible preferred stock received. Neither is valid as the determining factor in measuring the value of a publicly held company. See, *e.g.*, *Brundage* v. *New Jersey Zinc Co.*, 48 N.J. 450, 226 A.2d 585, 600 (1967); see also B. Graham, D. Dodd, S. Cottle, *Security Analysis* 217 (1962). In the ten years preceding the merger, the market price of Auto-Lite's stock never approached book value. (A. 640-43.)

[10] Petitioners' statement (p. 60) that they did not discover the claimed defect in the proxy statement "until long after" the shareholder meeting is not correct. As noted above (pp. 7-8, *supra*), petitioners decided to file their suit "several weeks" before the shareholder meeting. The complaint filed alleged that the controlling relationship between the respondent companies had not been adequately set forth and that the use of boldfaced type to state the directors' recommendation was misleading. (A. 7-8.)

ing the aid of the court, the standard for imposing liability should be stringent.[11]

Of course, certain instances may arise in which relief can be granted without a complete inquiry into all of the circumstances described above. If, for example, the shareholders are promised something which the corporation does not deliver, a court might well require fulfillment of the promise irrespective of the fairness of the transaction. Where there are flat misstatements or outright fraud pertaining to the very terms of the transaction, liability would be clear. But this case involves no such facts. A rule of automatic liability would unfairly blur the real differences between hypothetical situations and the concrete facts of this case.

B.

The Court Of Appeals Properly Remanded The Case For Trial.

Under Rule 14a-9, a "violation" can be found only after a statement in proxy material is judged "in the light of the circumstances under which it is made . . ." The Court of Appeals looked at only one circumstance—the emphasis and phrasing of the proxy statement—found a "violation," and remanded the case for consideration of the other circumstances. Its use of the term "violation" was a poor choice of words. (A. 1013.) But, by remanding the case for a consideration of all the circumstances surrounding the merger, the Court of Appeals reached the result required by the language of the Rule.

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[11] Judge Friendly in *General Time Corp.* v. *Talley Indus., Inc.*, 403 F.2d 159, 163 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969), condemned the practice of delaying until the day of the shareholder meeting to seek relief, and accordingly required at that time a "strong showing of materiality."

In remanding this case, the Court of Appeals directed the District Court to determine whether there was a "causal relationship" between the deficiency found in the proxy statement and the merger. (A. 1012.) Reference to that determination as "causal relationship" is understandable in the light of this Court's statement in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 431 (1964):

> "... the causal relationship of the proxy material and the merger are questions of fact to be resolved at trial, not here."[12]

Professor Loss has stated with respect to this ruling:

> "... [T]here are a number of other proxy opinions on causation—enough of them in the immediate wake of *Borak* to make it apparent that causation has now become the critical question in this area." 5 L. Loss, *Securities Regulation* 2933 (2d ed. Supp. 1969).

"Causal relationship"—a precondition of liability in virtually all areas of the law—is an important policy tool which insures that acts are weighed within their factual context so as to achieve a result in accordance with the goals sought to be protected.[13] Whether this process in the securities field is denominated "causal relationship" or "materiality", or simply framed in the language of Rule 14a-9, something more must be shown than that the proxy statement contained a misplaced emphasis. The deficiency

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[12] The proxy statement in *Borak* had precisely the same function as the one in this case. It, too, solicited proxies necessary for approval of the merger. If, as the government suggests, causation is shown merely by the fact that a proxy statement was used to secure approval of a merger, it would have been superfluous for this Court in *Borak* to refer the issue of "causal relationship" to the trial court.

[13] See, *e.g.*, 5 A. Corbin, Contracts §1019 (1964); W. Prosser, Torts 242-45 (3d ed. 1964); C. McCormick, Damages 269-70 (1935); Smith, *Legal Cause in Actions of Tort*, 25 Harv.L.Rev. 103, 233 (1911); Ryu, *Causation in the Criminal Law*, 106 U.Pa. L.Rev. 773 (1958).

in a proxy statement, whether constituting a misemphasis, misstatement, or omission, must be judged in light of all the relevant circumstances.

This Court in *Borak* made it clear that one of the chief purposes of the securities laws, set forth in the statutory language itself, is the protection of the shareholders' investment:

> "While this language [Section 14(a)] makes no specific reference to a private right of action, among its chief purposes is 'the protection of investors,' which certainly implies the availability of judicial relief where necessary to achieve that result." 377 U.S. at 432.

This fundamental statutory objective would in no sense be served in this case by automatic and mechanical application of rules of liability which can only serve to jeopardize the shareholders' financial interest and disenfranchise those shareholders who wanted the merger and benefitted from it. The fairness of the merger and the protection of the shareholders' investment should be of major concern to the trier of fact.

In addition, any ruling which negates causal relationship as a meaningful concept in Section 14(a) cases will have an identical effect in Section 10(b) litigation. In *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468 (1969), this Court equated Sections 10(b) and 14(a) in merger cases. As Professor Bromberg has noted, the elimination of causation from the securities law "would expose issuers, insiders, and perhaps others to immense liabilities for relatively minor misconduct." A. Bromberg, *Securities Laws: Fraud—SEC Rule 10b-5* 220 (1969). It is respectfully suggested that the government has not fully considered all of the ramifications of the position which it urges this Court to adopt.

C.

A Rule Of Automatic Liability Would Deny Respondents Their Day In Court.

Both petitioners and the government maintain that liability must flow from any defect in a proxy statement, irrespective of the surrounding circumstances. The premise underlying this position is that summary judgment should be the standard vehicle for establishing liability in securities cases. The government concedes that issues such as fairness are relevant, but only with respect to relief. (Gov't Br., p. 15.) Petitioners go further, contending that fairness is irrelevant, either with respect to liability or relief. (Pet. Br., pp. 68-69.)

There are several reasons why a rule of automatic liability without trial should not be adopted by this Court. First, the language of the Rule itself requires inquiry into the circumstances under which statements in proxy materials are made prior to a finding of liability. Second, serious consequences flow from a finding that a corporation has violated the securities laws. Third, summary judgment should not be used indiscriminately to displace trials in the resolution of securities claims.

The government as amicus concedes that the District Court must at some point consider the fairness of the merger. Prudence dictates that this inquiry be made prior to a determination of liability. Adverse consequences must, of course, flow from the imposition of liability. The Second Circuit recently emphasized in *Globus* v. *Law Research Service, Inc.*, CCH Fed. Sec. L. Rep. ¶ 92,474, at p. 98,240 (2d Cir. 1969), that "there always lurks the psychological deterrent of being branded a knowing violator of the law. This is particularly true in an industry [dealing in securi-

ties] where, as the sages put it, a good name is worth more than a crown." The label of "violator" is not to be lightly imposed without trial, especially where, as here, there has been no showing of fraud, the SEC cleared the proxy statement, and the terms of the merger were fair to the shareholders and were overwhelmingly approved by them.

Petitioners and the government seek a rule which would abrogate respondents' right to a trial on the issue of liability—a step which the Court of Appeals would not take. It is significant in this regard that neither court below was willing to make a finding of liability based solely upon what they felt to be an inadequate disclosure in the proxy statement. The District Court felt that some other element was necessary: the impact of the merger on the national economy and the public attitude toward conglomerates and the antitrust laws. The Court of Appeals likewise felt the need of finding an additional element, which it called "causal relationship."

It would be improper to circumvent the trial process where the SEC's own Rule requires an inquiry into the circumstances. This Court's warning in *Kennedy* v. *Silas Mason Co.*, 334 U.S. 249, 256-57 (1948), is pertinent here:

> "[S]ummary procedures, however salutory where issues are clear-cut and simple, present a treacherous record for deciding issues of far-flung import, on which this Court should draw inferences with caution from complicated courses of legislation, contracting and practice."

Petitioners and the government claim that any inquiry into the circumstances here is impossible because the trier of fact cannot "reconstruct the balloting" or test "whether or not the result of the shareholder vote would have been

different." (Pet. Br., p. 22; Gov't Br., p. 12.) In a Section 14(a) case, the trier of fact necessarily must at some point make a determination as to the probable effect of any omission on the challenged transaction. The suggestion that such a process is impractical or impossible simply ignores the very nature of the claim asserted. It further assumes the inability of courts to make determinations which they have been making since the inception of Anglo-American law.

Respondents repeatedly requested that this case proceed to trial. (A. 460, 465, 471-72, 691-92, 743, 759, 763, 776, 873, 886, 898-99, 902.) They are not to blame for this case languishing in the District Court. Indeed, they urged that summary procedures would ultimately prolong the litigation. (A. 745-46, 748-49, 751-52.) This case presents "another mistaken effort to save time by an attempt to dispose of a complicated state of facts on motion for summary judgment." *Bozant* v. *Bank of New York*, 156 F.2d 787, 790 (2d Cir. 1946) (L. Hand, J.).

Fairness to all parties concerned necessitates a trial where the facts concerning the merger can be fully presented. No defendant, big or small, should be deprived of his day in court.

III.

THE PRACTICAL PROBLEMS ENVISIONED BY THE GOVERNMENT CAN BE RESOLVED WITHIN THE RATIONALE OF THE COURT OF APPEALS BY A RULE ENCOURAGING PROMPT CORRECTIVE ACTION.

If this Court concludes that the proxy statement was defective in its emphasis, this case raises questions as to the allocation of the burden of proof and as to the point in time at which fees and costs should be awarded.

The government as amicus does not address itself to the question whether the proxy statement here should have been phrased differently, but assumes the existence of a material omission. Based on this assumption, it suggests that liability should automatically follow in order to expedite public and private enforcement of the SEC Rules. The purposes of the securities laws can better be served without short-circuiting a meaningful inquiry into the facts of this case. Furthermore, the government's suggestion, if applied in all cases, will not encourage prompt action on the part of those who challenge proxy material.

The government's position may have merit where a hearing on the claim is held prior to the shareholder vote. At the pre-meeting stage, courts need not inquire into circumstances such as fairness or the effect of a defective statement on the vote. But the government's suggestion does not provide a complete answer where, as here, the shareholders have voted and the merger has taken place. In such a situation, there are other circumstances present, and placing the burden of proof on respondents to show them (as was done by the Court of Appeals) is the only rational method for giving full effect to the standards set forth in Rule 14a-9. Adoption of a minimal test for liability at the pre-meeting stage when there are fewer circumstances to consider will encourage complainants to act diligently.

Prior to the shareholder meeting the ease with which relief may be granted and the salutary effect of such relief on shareholder suffrage justifies a minimal test of liability. At that point, proxy material can be easily corrected and the meeting postponed if necessary. Federal courts faced with the practicalities of securities litigation have recognized that "the application for a preliminary

injunction is the time when relief can best be given." *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969). In fact, they have found it so desirable to have proxy material passed upon before the shareholder vote that they have adopted a test of liability in pre-meeting cases less stringent than that applied where retrospective relief is sought. *Studebaker Corp.* v. *Gittlin*, 360 F.2d 692, 698 (2d Cir. 1966); see also *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 547 (2d Cir. 1967) (10b-5 case). Awarding of attorneys' fees to successful litigants at the injunctive stage would serve as an additional incentive to prompt assertion of claimed violations of the Proxy Rules.

Once a meeting has been held and the transaction consummated, the elements of a claim for monetary damages or rescission differ significantly from those in an action seeking only injunctive relief. See *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-93 (1963).[14] The corrective relief which petitioners would have received at the preliminary stage, when contrasted with that which

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[14] Professor Loss notes:

"Furthermore, whether in actions under the SEC rules or in nonstatutory actions based on alleged misstatements in the solicitation of proxies or allegations of other improprieties or threatened improprieties in voting, it should become increasingly difficult to arouse the chancellor's conscience as the plaintiff proceeds from (1) a prayer merely to postpone the taking of the vote to (2) a prayer to enjoin the consummation of the action approved by the vote to (3) a prayer to set aside the action after its consummation. This should be especially true when a substantial period has expired since the vote or when the rights of innocent third parties have intervened, even apart from traditional laches which may bar a post-meeting plaintiff who had time to sue before the meeting." 2 L. Loss, *Securities Regulation* 961-62 (2d ed. 1961).

they now seek, points up the need for differing tests. Recognizing this, the Court of Appeals noted that had petitioners "timely sought" corrective action prior to the holding of the shareholder meeting, a different case would have been presented. (A. 1011.)

Corporate suffrage is furthered by full disclosure. Yet petitioners deliberately chose to withhold their complaint. If petitioners believed that the shareholders should have had additional or more correct information, they were under a duty to so advise management or the SEC. The SEC has stated that management should be given "an opportunity to avoid . . . defects in the preparation of proxy material." 29th SEC Annual Rep. 53 (1963).

Despite petitioners' deliberate delay, the government suggests that petitioners be awarded interim attorneys' fees and litigation expenses. The government's position, contrary to sound policy, would encourage plaintiffs to lie in wait until it is too late to rectify alleged deficiencies—the very tactics employed here. A lack of an award of interim fees has not deterred the prosecution of complex litigation under the securities laws or in other fields. Fees and expenses are not advanced in antitrust matters, even though cases of that type normally require the retention of accountants and other financial experts. Attorneys have vigorously prosecuted complicated cases with only the incentive of a fee award at the end of the suit.

None of the authorities cited by the government (pp. 21-24) support an interim award of fees. All involved awards made *after* the conclusion of the case on the merits and *after* a fund had been created or some other bene-

ficial result had been achieved.[15] The degree of success and the benefit conferred traditionally have determined the amount of the fee award. Professor Hornstein, upon whom the government relies, points out that, "The test of success . . . is the ultimate result, not the intermediate rulings." *The Counsel Fee in Stockholder's Derivative Suits,* 39 Colum.L.Rev. 784, 798 (1939). Any award of fees should properly await the final outcome of this case.[16]

IV.

THE FINDING OF A DEFECT IN A PROXY STATEMENT DOES NOT REQUIRE UNWINDING THE MERGER.

Petitioners demand relief in two forms, restitution or rescission. Both are based on the assumption that the merger is "void." They claim that their right to these

[15] *Sprague* v. *Ticonic National Bank,* 307 U.S. 161, 166 (1939) (plaintiff had preserved 14 other trust funds besides the one of which she was a beneficiary); *Trustees* v. *Greenough,* 105 U.S. 527, 529 (1882) (plaintiff had saved and returned to a trust fund millions of acres of land and considerable amounts of money); *Maggiore* v. *Bradford,* 310 F.2d 519 (6th Cir. 1962), *cert. denied,* 372 U.S. 934 (1963) (plaintiffs had prevented a transaction which would have resulted in a $2,700,000 depletion of corporate assets); *Smolowe* v. *Delendo Corp.,* 136 F.2d 231, 241 (2d Cir.), *cert. denied,* 320 U.S. 751 (1943) (plaintiffs had recovered short-swing profits for the corporation).

[16] The government suggests safeguards which, of course, would be appropriate if prospective fees are allowed. Among these, "the plaintiffs, in order to qualify for reimbursement of their subsequent litigation expenses" should be required "to make a preliminary showing of a substantial possibility that the defendants' proof of fairness might be successfully controverted." Only by adopting safeguards can this Court minimize the "possible abuse" which the government candidly admits is inherent in the allowance of prospective fees and expenses. (Gov't Br., p. 21.)

remedies must be "unobstructed by any inquiry into 'fairness' . . ." (Pet. Br., p. 69.)

Petitioners' request for "restitution" is nothing more than a thinly-veiled attempt to recover damages without any inquiry as to injury. The question of monetary damages is not before this Court and was not considered by either court below. In any event, the government as amicus has covered this point: "Where, as here, the misleading aspect of the proxy solicitation did not relate to the terms of the merger, the stockholders should be entitled to monetary relief only to the extent that they can show they suffered pecuniary damages from the merger." (Br., pp. 10-11.)

Unwinding this merger would be improper and irrational. A decree of rescission would not only injure the investment interests of the Auto-Lite shareholders who have remained shareholders in the merged corporation, but would be wholly unfair to the more than 7,000 persons who have become Eltra shareholders during the six-year period since the consummation of the merger. As the government properly notes, " . . . it is far from certain that the shareholders the plaintiffs represent would wish to have the merger set aside." (Gov't Br., p. 17.) Of all the persons interested in this transaction, including 15,643 Eltra shareholders, only the two petitioners have expressed a desire for rescission.

Neither this Court nor any other federal court has held that Section 29(b) of the Securities Exchange Act requires the voiding of a merger simply because a violation of one of the provisions of the Act has been established.

The "voiding" provision of Section 29(b) does not apply where the rights of innocent third parties have intervened.[17]

This Court in *Borak*, while holding that retrospective relief is available with respect to a consummated merger transaction, expressly disclaimed any intention of setting forth rigid rules as to relief:

> "Our finding that federal courts have the power to grant all necessary remedial relief is not to be construed as any indication of what we believe to be the necessary and appropriate relief in this case. . . . Whatever remedy is necessary must await the trial on the merits." 377 U.S. at 435.[18]

In *A. C. Frost & Co.* v. *Coeur d'Alene Mines Corp.*, 312 U.S. 38 (1941), this Court had before it the question of whether a particular contract to purchase stock was void and thus should be rescinded because the entire issue of securities had not been registered under the 1933 Act. Reversing the lower court's annulment of the contract, this Court held:

> "Here the clear legislative purpose was protection of innocent purchasers of securities. They are given definite remedies inconsistent with the idea that every

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[17] The pertinent provisions of Section 29(b) are not set forth in petitioners' brief. (Br., p. 3.) The omitted language, contained in the government's brief at page 3, provides that a contract shall be void only as against those persons who acquired rights "with actual knowledge of the facts" constituting a violation of the Act. 48 Stat. 903, as amended, 15 U.S.C. §78cc(b) (1964).

[18] In *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 462 (1969), this Court stated that its decision should not be taken as an intimation of "what remedies would be appropriate should a violation be found after a trial on the merits."

> contract having relation to sales of unregistered shares is absolutely void; and to accept the conclusion reached by the supreme court below would probably seriously hinder rather than aid the real purpose of the statute." 312 U.S. at 43.

The corporation formed by the Auto-Lite-Mergenthaler merger is "not inherently unlawful." (See Gov't Br., p. 15.) Accordingly, the antitrust divestment cases cited by petitioners (p. 64) are inapposite.

> "Unlike the antitrust laws—where the motivation for divestiture would be to restore the economic status quo—there is no such compelling policy in the securities laws where the shareholders can be adequately compensated by damages." Fleischer, *"Federal Corporation Law": An Assessment,* 78 Harv. L. Rev. 1146, 1172 (1965).

Respondents and the amicus agree that the drastic remedy of rescission is not required under the facts of this case. Respondents request that this Court so hold.

CONCLUSION

The merger proxy statement more than amply disclosed the relationship between Auto-Lite and Mergenthaler. In any event, liability should not be imposed in this case in the absence of a trial, at which the circumstances surrounding the merger must be considered. Relevant circumstances under Rule 14a-9 would include all of the disclosures which were made, the SEC's clearance of the proxy statement, petitioners' deliberate delay, and the overwhelming attractiveness of the transaction to the Auto-Lite shareholders. This Court should announce

a rule promoting prompt action by persons having knowledge of defects in proxy material. Certainly, not every defect requires the voiding of a consummated transaction and the unwinding of a fair merger, particularly where, as here, the defect found does not relate to the terms of the transaction.

The Court of Appeals properly remanded this case to the District Court for trial. It incorrectly held, however, that the proxy statement violated the Proxy Rules because of its phrasing. Accordingly, the decision of the Court of Appeals should be affirmed in part and reversed in part and this cause remanded to the District Court for trial.

Respectfully submitted,

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October 8, 1969

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No. 64

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In the

Supreme Court of the United States

OCTOBER TERM, 1969.

ELMER E. MILLS AND LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969.

No. 64

ELMER E. MILLS AND LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

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REPLY BRIEF OF PETITIONERS ELMER E. MILLS AND LOUIS SUSMAN

I. THE RESPONDENTS' VIOLATION IS NOT BEFORE THIS COURT FOR REVIEW.

A. Respondents' Argument on the Violation Is Improper.

The respondents have briefed the wrong issues. Like a ship in the night, their brief silently passes the questions presented by the Petition for Certiorari and de-

parts instead upon an uncharted course, apparently assuming that this Court will conduct a trial *de novo* of the whole action. From beginning to end, respondents' brief embodies this basic misconception. Its beginning states new and different "questions presented," seeking to raise new issues completely extraneous to anything in the petition. Its end is a prayer not that the judgment of the Court of Appeals be affirmed, but rather that it be *reversed.* The argument offered in its intervening pages must be disregarded on three grounds.

1. Only Questions Presented in the Petition Will Be Considered.

The Rules of this Court plainly prohibit such intrusion of extraneous issues. "Only the questions set forth in the petition or fairly comprised therein will be considered by the court." Rule 23.1(c); *see also* Rule 40.1(d)(2). The decisions enforce this Rule to its letter, declining to consider arguments beyond the scope of the questions presented. The principle is so clear and well-settled that its application is usually relegated to footnote treatment. *See, e.g., J. I. Case Co.* v. *Borak,* 377 U.S. 426, 428-29, 429 n.3 (1964); *United States* v. *O'Brien,* 391 U.S. 367, 368 n.31 (1968).

The Court's control of its own docket, concentrating its energies upon questions worthy of its attention, requires that argument here be confined strictly to questions which the Court has decided to consider in its grant of certiorari. Respondents' approach would convert this Court's rule into a trap for the unwary petitioner, who would scrupulously observe the limits of the questions presented in his opening brief only to be confronted with the task of meeting in a hurried reply brief every other issue which the respondents might choose to intrude. To countenance

he practice would unduly lengthen briefs and arguments, nd impede the prompt dispatch of that judicial business vhich the Court has found deserving of its time. For hese reasons, Mr. Justice Jackson forcefully reminded he bar, "We disapprove the practice of smuggling addi- ional questions into a case after we grant certiorari. The ssues here are fixed by the petition unless we limit the grant, as frequently we do to avoid settled, frivolous or state law questions." *Irvine* v. *California*, 347 U.S. 128, 129-30 (1954).

2. Without a Cross-Petition, Respondents Cannot Seek Reversal.

The questions presented by the petition raise, in various phrasings, the single question whether the Court of Appeals erred in holding that causation must be determined, in a case where a corporate merger was approved through unlawful proxy solicitation, by a factual finding that enough votes were changed by a specific misstatement or omission to change the outcome of the shareholder vote. In a separate portion of its opinion, under a separate heading, the Court of Appeals had held that respondents were guilty of violating the securities laws. The judgment below thus ruled in favor of respondents on the causation question, and in petitioners' favor on the question of the violation. The judgment of the District Court was accordingly affirmed in part and reversed in part, and the case was remanded solely for the purpose of further proceedings on the question of causation alone. Although respondents now protest the "serious consequences . . . of being branded a knowing violator of the law" (Resp. Br. 27), they made no attempt to obtain review of that decision despite its finality, by filing their own petition for certiorari. Nor did they even bother to

file a cross-petition, under this Court's Rule 21(3), when these petitioners sought certiorari. By-passing the need for this Court's consent to review that decision, respondents have nonetheless devoted their brief to arguments avowedly seeking reversal of the Court of Appeals judgment dealing with their violation.

Their brief must be disregarded. It is elementary that a respondent "is not entitled to be heard in opposition to the parts of the decision of the Court of Appeals which were adverse to it . . . but only in support of the parts which were in its favor. As to the former it has acquiesced and become concluded by not seasonably petitioning for a review." *Alexander* v. *Cosden Pipe Line Co.*, 290 U.S. 484, 487 (1934). *See also Lloyd Sabaudo, S.A.*, v. *Elting*, 287 U.S. 329, 331 (1932). "A respondent or an appellee may urge any matter appearing in the record in support of a judgment, but he may not attack it even upon grounds asserted in the court below, in an effort to have this Court reverse it, when he himself has not sought review of the whole judgment, or of that portion which is adverse to him." *LeTulle* v. *Scofield*, 308 U.S. 415, 421-22 (1940) (footnotes omitted).

Under these principles, the Court has repeatedly held that a defendant, as respondent, will not be heard to argue, without a cross-petition made and allowed, that the Court of Appeals' rejection of a defense was error and should be reversed. *See, e.g., Alaska Industrial Board* v. *Chugach Electrical Ass'n., Inc.*, 356 U.S. 320, 324-25 (1958), where this Court reversed the Court of Appeals order setting aside a workmen's compensation award, on the merits, and ruled that the argument that the award had been made beyond the board's jurisdiction was "not open to respondent at this stage." *Cf. Kellogg Co.* v.

National Biscuit Co., 305 U.S. 111, 122-23 (1938); *Morley Construction Co.* v. *Maryland Casualty Co.*, 300 U.S. 185, 190-92 (1937). Here respondents seek to go further, not merely to raise new and separate defenses on which the Court of Appeals might have reached the same result, but to reverse that result. The decision below unequivocally adjudicated a violation, and because of that violation directed that respondents would bear the burden of proof in further proceedings confined to the issue of causation alone. Respondents' arguments that the proxy statement made "full disclosure" and that any nondisclosure was trivial inevitably are pointed toward a reversal of the Court of Appeals decision, as they explicitly confess in their Conclusion (Resp. Br. 37), and elsewhere, (Resp. Br. 13, 19). Those arguments have no place in this Court.

3. Review of the Sufficiency of the Evidence to Support the Finding of Violation Is Foreclosed by the Two-Court Rule.

Respondents' argument that the proxy statement involved no violation of the securities laws must be disregarded on still a third ground. The question they now seek to raise is purely a question of the sufficiency of the uncontested evidence to support the finding of both courts below—and of all four judges—that the proxy statement was unlawful. Its resolution turned upon the unique contents of the particular proxy statement at issue, and upon specifics of the facts which were not disclosed. It raises no important question of federal law nor any possibility of conflict with decisions of other courts. The question whether these particular disclosures measured up to the demanding standards of federal law has no significance beyond the limits of this individual and unique case. Respondents' brief, dealing with facts not with law,

is an attempt to engage this Court in weighing the evidence. It asks the Court to scour a record of three volumes and more than a thousand pages, to decide a factual question already fully considered by two courts.

This Court does not sit to decide isolated and unique questions of fact. Certiorari on those issues, had respondents petitioned, would surely have been denied in adherence "to the usual rule of non-interference where conclusions of Circuit Courts of Appeals depend on appreciation of circumstances which admit of different interpretations." *FTC* v. *Standard Oil Co.*, 355 U.S. 396, 400, 401 (1958). The "two-court" rule, that concurrent findings of two lower courts will not be disturbed, suffices to support denial of certiorari and applies as well to foreclose consideration of the weight and sufficiency of evidence when a case is properly brought before this Court on other issues raising questions of law. *See Goodyear Tire & Rubber Co., Inc.* v. *Ray-O-Vac Co.*, 321 U.S. 275, 278 (1944); *Berenyi* v. *Immigration Service*, 385 U.S. 630, 635-36 (1967).[1]

B. If the Question of Violation Were Opened for Review, Petitioners Should Be Entitled to Brief and Argue That Issue.

The Rules of this Court require that briefs shall be directed only to the questions presented in the petition. Rule 40.1(d)(2). In obedience to this command, we

[1] This two-court rule was applied in *Baker* v. *Schofield*, 243 U.S. 114 (1917), to affirm a judgment holding that a defendant in a conflict-of-interest position will not be permitted "to take advantage of his own wrong" and holding that "he can take nothing by his wrongful act and can be compelled to restore the property. . . ." (pages 118, 119). Such relief is also appropriate here. See pp. 18-19, below.

refrain in this Reply from responding to the respondents' improper argument seeking to overturn the decision that they committed a violation of the securities laws. In this compliance, we rely upon the assurance in Rule 40.1(d)(2): "Questions not presented according to this paragraph will be disregarded, save as the court, at its option, may notice a plain error not presented." Should the Court be disposed to depart from its usual practice, and to consider the issue of the violation, petitioners request an opportunity to be heard on the issue, and to submit a full brief and argument, as we would have been entitled to do if certiorari had been regularly sought and granted on that question. An outline of such a brief is included as an appendix to this Reply, against any hypothetical argument that the two courts' finding of a violation might somehow be viewed as "plain error."

With this qualification, and in keeping with the practice in this Court, we have also refrained from making a separate motion asking the Court to strike the respondents' brief from the files, and have proceeded upon the premise that their improper argument "will be disregarded." Rule 40.1(d)(2).

II. DETERMINATION OF THE APPROPRIATE RELIEF IS NOT A PREREQUISITE TO ADJUDICATION OF LIABILITY AND WAS PROPERLY RESERVED FOR FUTURE PROCEEDINGS TO BE CONDUCTED UNDER THIS COURT'S GUIDELINES.

At the trial court level, this action embraced three distinct issues: (1) the violation of the proxy solicitation laws, (2) the causal relationship between the proxy solicitation and the merger, and (3) the relief to be granted. The first issue, concerning the violation, is not before this Court, for the reasons stated in the preceding section of

this Reply. The third issue, relating to the proper form of relief, has not yet been considered by the District Court, and has been reserved for further proceedings there. Only the second issue, of causation, is now presented for final decision.

Respondents, however, have devoted their brief wholly to the extraneous issues, as revealed by their Summary of Argument, 13-15. The first two paragraphs of that summary relate exclusively to the finding that respondents' proxy statement was in violation of federal law, a question not properly here. The remaining three paragraphs of that summary deal only with the relief to be granted, an issue not yet ripe. The brief is tantamount to a confession of error on the only issue properly before this Court: the question whether the Court of Appeals erred in its holding that causal relationship between the proxy solicitation and the merger was not established by the admitted fact that proxies produced by the unlawful solicitation were essential to approval of the merger.

A. Summary Judgment Was Properly Entered on the Issue of Liability Alone.

The question of the kind and quantity of relief to be afforded remains for future litigation and adjudication. The District Court determined only the issue of liability, leaving open the choice among available remedies, ranging from nominal damages only to a decree of divestiture. Respondents insist that it is somehow improper for a court to declare the underlying substantive rights without at the same time determining the remedy. *But see Brown* v. *Board of Education,* 347 U.S. 483 (1954). Thus they protest being "held liable" or being subjected to "automatic liability" without their "day in court" (Resp. Br. 20, 27-28) on questions which affect only the issue of

relief. It is not enough, in their view, that they are assured of a full and fair opportunity to litigate the question of the remedy in the future. In taking this position, respondents are quarreling not with the actions of the courts below, but with the rules of procedure promulgated by this Court. Rule 56(c), Fed. R. Civ. P., provides: "A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages." This salutary rule is intended to eliminate the waste of unnecessary trials on supposed issues drawn by the parties' contentions but not backed up by evidence, and to encourage the reasonable practice of narrowing the trial to issues fairly requiring it, and adjudicating in advance the paper issues resolvable on the uncontradicted facts. This Court's recent amendments confirm and reinforce the policy. *See* Advisory Committee Note, 31 F.R.D. 648 (1962); *First National Bank* v. *Cities Service Co.*, 391 U.S. 253, 289-90 (1968).

B. Relief After Unlawful Consummation of the Merger Is Not Foreclosed by Any Supposed Lack of Prompt Action by Petitioners.

Refusing to accept the separation of liability and remedy, respondents urge that the lower courts erred in finding a violation of the securities laws without first holding a trial on "the stage of transaction at which relief is sought (whether pre-vote or post-vote)." Resp. Br. 20. The question whether respondents violated the law cannot depend, in logic or in law, on the subsequent action of petitioners' filing suit, whether early or late. Since the date of filing affects neither the violation nor its causal relationship to the merger, respondents are apparently asserting that timing is relevant to the relief to be granted.

Aside from lack of legal merit, the claim that petitioners are chargeable with delay has no foundation in fact. The proxy statement was *mailed* on June 4, 1963 (A. 536), and the suit was filed on June 26, 1963 (A. 3), three weeks to the day from the moment when any minority shareholder could first have laid eyes on the proxy statement. In view of the complexity of that 108 page document and the duty to investigate before suit, as imposed by this Court (*see* Fed. R. Civ. P. 11), it verges on the ridiculous to suggest that petitioners deliberately conspired to "lie in wait" before filing suit. Resp. Br. 32. On the contrary, to one versed in the practical realities of law practice, such prompt filing in a complicated case would reflect extraordinary diligence. Moreover, respondents flatly misstate the record in reciting that " 'Several weeks' before the scheduled shareholder meeting, it was decided that a lawsuit would be filed." Resp. Br. 7, 23 n. 10. On the contrary, the record states that it was "about two or three weeks" after plaintiffs consulted their attorney before it was decided that the complaint would be filed. A. 853, 815-17.[2] Upon analysis, respondents' effort to weave a conspiracy among petitioners and their attorneys for "deliberate delay" in filing the suit, for some unstated purpose, is revealed as a figment of their misreading of the record.

Respondents also complain that petitioners did not bring the half-truths and omissions to the attention of the Auto-Lite management before the stockholders' meeting. Resp. Br. 7-8. Whether "management" knew of petitioners' suit before the meeting is not disclosed by the

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[2] The testimony cited by respondents does not refer to the time when the decision to sue was made, as respondents state to this Court, but rather to the time when the client made up his own mind that the merger was unfair. A. 829.

record, but respondents' off-the-record assertion of no notice (Resp. Br. 8) is difficult to reconcile with the fact, shown of record, that service of the summons and complaint was effected upon Auto-Lite's registered agent the day before that meeting. In any event, "management" certainly had full and peculiar knowledge of the facts omitted from the proxy statement, which they had presented in detail and under oath to the SEC in the separate proceeding under the Investment Company Act. A. 237. Respondents' argument is calculated to invert the congressional plan, and to impose upon the shareholder the duty to make full disclosure of all relevant facts to the corporate management.

On the same theme, respondents plaintively protest that petitioners did not seek and obtain a temporary restraining order, to stop them from their misdeeds. Although they were already twice enjoined, by statute and by the proxy rule, from obtaining merger approval through unlawful proxy solicitation, they assert they did no wrong absent a judicial order added to those legislative and administrative prohibitions. Petitioners' complaint prayed for a permanent injunction against use of the unlawfully solicited proxies and against consummation of the merger. A. 23-24. They did not file a motion for a temporary restraining order, for a number of good reasons. The requirement that an injunction bond be posted would have compelled them to risk their fortunes on the possibility that such a hasty and summary order would not later be set aside. Their chances of obtaining a valid restraining order were remote at best, in view of the strict limits imposed by this Court on such extraordinary relief.[3] Such an order will not be granted on a showing based on information and belief (*Bowles* v. *Montgomery Ward & Co.*, 143 F. 2d 38, 42 (1944)), the basis

[3] *See* Fed. R. Civ. P. 65.

of the original complaint here. A. 25-26, 846. The information which proved petitioners' charge and became the foundation of summary judgment was not discovered until months later, A. 828, 839, and shortly thereafter it was introduced by an amendment to the complaint. A. 169-71, 178. Until that evidence was discovered to support petitioners' charge, no injunctive action could have been taken, and petitioners can be charged with no lack of diligence. *See Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U.S. 238, 243 (1944).

Moreover, the lower courts typically take the position that a minority shareholder will suffer no irreparable harm if a meeting is held to count the ballots, since he can be adequately protected by retrospective relief, setting aside the vote, if full litigation reveals that a violation occurred.[4] *See, e.g., Mack* v. *Mishkin*, 172 F. Supp. 885, 889 (S.D.N.Y. 1959); *Sherman* v. *Posner*, 266 F. Supp. 871, 873 (S.D.N.Y. 1966). On the other hand, the defendant corporation may suffer irreparable harm if a restraining order is improperly granted, since a delay in the meeting will make the proxies stale and disfranchise new shareholders. *See Ainslie* v. *Sandquist*, 270 F. Supp. 382 (D. Mass. 1967); *Sherman* v. *Posner*, 266 F. Supp. 871, 874 (S.D.N.Y. 1966). Respondents would nonetheless urge this Court to adopt a rule requiring minority shareholders to seek emergency relief which they probably

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[4] These considerations were recently invoked by Mr. Justice Black in denying an application to him as a single Justice for an injunction against a public election. "If this election were held, applicants could later bring suit to have it set aside. I thus do not see why these plans should be stopped in midstream, in a case in which the legal issues are unclear, when the election cannot result in the severe irreparable harm necessary to justify the issuance of the extraordinary remedy of an injunction by an individual Justice." *Oden* v. *Brittain*, ... U.S. ....., 90 S. Ct. 4, 5 (August 13, 1969).

could not obtain, and encouraging the use of drastic and extraordinary remedies based on hurried and tentative hearings.

By the time petitioners could first have taken any action, the tainted proxies were already in the stockholders' hands and in the process of being executed and returned. The stockholders' meeting involved nothing more than the clerical task of tallying the proxy votes, and all votes counted were cast by proxy. A. 688. Whether the official vote count was completed before or after respondents learned of the suit is a matter of no consequence. At either time they were equally free to re-solicit the proxies with corrective or curative proxy materials.

Moreover, respondents do not carry their off-the-record assertions about management's knowledge to the extent of claiming that management was still ignorant of the suit when they acted to consummate the merger by turning over the assets, proceeding with the exchange of preferred shares and so forth. These steps were taken because respondents deliberately chose to persist in their violation, and to proceed despite full knowledge of the charges in the pending litigation. At any time they could have acknowledged the deficiency in their proxy statement, sent out a new statement, and held a new meeting. They decided instead to capitalize on the votes produced by unlawful proxy solicitation, and to risk the consequences. By a perversion of equitable principles, they now claim protection by reason of their wilful persistence in their wrongdoing. *Cf. Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U.S. 238, 247 (1944).

Respondents also seek to bring themselves under the shelter of protections for innocent third parties by asserting, off the record, that many persons have become

shareholders since the merger was voted upon. If such persons bought into the corporation without knowledge of the pending suit, the fault belongs to the respondents, who are responsible under federal law for disclosing information affecting the securities which they issue. In any event, their attempt to borrow a cloak of innocence defies the whole concept of the business corporation. In effect, they ask the Court to rule that a corporation can never be held accountable for its wrongs, because persons may have become shareholders without knowledge of the unlawful acts committed by management.

Respondents declare that "This Court should announce a rule promoting prompt action by persons having knowledge of defects in proxy material." Resp. Br. 36-37. They leave unstated the content of the rule which they urge, and their recommendations for the penalty if "prompt action" is not taken. In the light of the fact that the only "prompt action" not taken by petitioners was a motion for a temporary restraining order, and in the light of respondents' argument that liability cannot be adjudged without considering *when* "relief was sought" (Resp. Br. 20), respondents' suggestion emerges as nothing more than an elaborately disguised repetition of the rejected rule that the only relief which can be given for unlawful proxy solicitation is prospective. This rule had been adopted by the Sixth Circuit in *Dann* v. *Studebaker-Packard Corporation,* 288 F. 2d 201 (6th Cir. 1961). It was emphatically overruled by this Court in *J. I. Case Co.* v. *Borak,* 377 U. S. 426, 434 (1964), with its holding that there is no "merit in the contention that . . . remedies are limited to prospective relief." *See* Pet. Br. 60-61.

In sum, petitioners took prompt action at the earliest possible date consistent with a careful investigation and

consideration of their objections. Their legal position was fully and formally presented in a complaint, and was officially brought to the attention of respondents by means approved by the Court's procedural rules. Respondents were fully informed before they took any significant action to consummate the merger. If they had wanted a preliminary adjudication before they proceeded, they could have taken the initiative to obtain it, and cannot complain that petitioners did not indulge the futile gesture of seeking a temporary restraining order. If respondent's violation carries no consequences under these circumstances, and the lower courts can "attach no responsibility to the use of misleading proxy statements, the whole purpose of the section [§14] might be frustrated." *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 434-35 (1964).

C. Relief in the Form of Divestiture or Monetary Restitution Is Available Without Inquiry into the Fairness of the Exchange Ratio.

Although the question of the form of the final relief to be awarded is not presented for final decision at this stage, it is appropriate nevertheless for this Court to lay down the guidelines for the District Court's future determination of this issue, to hasten the ultimate disposition of this protracted litigation, to eliminate "the difficulty of fashioning effective relief . . . before remanding the case so that the trial court may go forward with further proceedings without undue delay", *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969), and to direct that the command of federal law *shall be enforced* according to its letter. *Cf. Alexander* v. *Holmes County Board of Education*, ... U.S. ....., No. 632 (Oct. 29, 1969).

Respondents attempt to raise up a straw man of "Draconian" extremism by insisting that petitioners are

arguing that "unwinding the merger" by a decree of divestiture is required in every case. Resp. Br. 15. As the opening brief makes clear (Pet Br. 64), petitioners take no such position. At the other extreme, respondents ask this Court to rule that the "remedy of rescission is not required under the facts of this case." Resp. Br. 36. Whether rescission in the sense of divestiture is "required under the facts" can be determined only after the facts are developed in the future hearings ordered by the District Court. To rule the remedy out of consideration now would "emasculate the securities laws by forbidding remedies which might prove to be essential." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 463-64 (1969).

Alternatively, the District Court may award monetary relief, as respondents concede. Of course, as the Government suggests, (Gov't Br. 17-18), petitioners would not necessarily be entitled to compensatory monetary relief by way of an award of substantial damages simply because a violation occurred. On the other hand, the availability of substantial monetary relief does not depend upon the "fairness" of the merger, in the sense of a fair ratio of exchange to be shown by the opinion of financial experts. Respondents themselves concede that substantial damages could be recovered, even though the merger were fair, if a misrepresentation pertains "to the very terms of the transaction". Resp. Br. 24. A misrepresentation which relates to the financial terms of the merger provides a ready and convenient measure of damages: the defendant can be compelled to live up to his promise by paying the difference. *See* Gov't. Br. 18. But such cases are likely to be rare in practice, since a flat misrepresentation of value would incur a grave risk of exposure. More common, and more insidious, are misstatements, half-

truths, and omissions which are not susceptible of direct, objective refutation. Most of the items of information required by the SEC's rules and regulations for proxy statements would be unrelated to the specific financial terms of a merger.[5] In these more common cases, one measure of damages might be provided by a re-examination of the fairness of the merger ratio, as the Government suggests. Gov't Br., 18-19.

But other measures of damages may be equally available. The respondents' out-of-hand dismissal of the law of restitution as "nothing more than a thinly-veiled attempt to recover damages without any inquiry as to injury" (Resp. Br. 34), ignores the most basic concepts of justice. See DAWSON, UNJUST ENRICHMENT, 3-5, [illegible] 14, 147-48 (1951). The restitutionary measure is unnecessary or inquired when other measures are impeded by difficulties of proof, where for example "the combined companies have been intermingled." Gov't Br. 18. *See* Fuller and Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L. J. 52, 374 (1937). It may be fairly supposed that Congress recognized such difficulties of proof, and shaped its language to avoid them, in declaring that contracts in violation of the proxy rules "shall be void . . . as regards the rights of any person" who engaged in the violation. Section 29(b), Securities Exchange Act of 1934, 48 Stat. 903. The fair intendment of this language is that, in assessing monetary relief, the parties should be restored financially to the position they would have occupied if there had been no merger, and more specifically, that the violator should take no right, benefit, or gain by his

[5] Schedule 14A promulgated under the Securities Exchange Act of 1934 (17 C.F.R. 240.14a-101), Items 1-6, 8, 12, 13, 16-21; *see also* Rule 14a-9, Note b, c, d (17 C.F.R. 240.14a-9).

violation of federal laws. This restitutionary remedy has been directly adopted by Congress for redress of the public disclosure provisions of the 1933 Act (Section 12, Securities Act of 1933, 48 Stat. 84), and is the obvious and logical remedy to be afforded by the courts under the 1934 Act in the enforcement of its public disclosure provisions. The SEC has recognized this in its recently proposed revision of Rule 133, to bring a merger proxy statement within the scope of the 1933 Act and its restitutionary remedy for a defective prospectus. *See* SEC Release No. 8711, Securities Exchange Act of 1934 (Oct. 9, 1969).[6] *See* Pet. Br. 29-32.

The courts, as well as Congress and the Commission, have found restitution to be an appropriate remedy for violations of the securities laws. Its availability does not depend upon whether the plaintiff might also have recovered upon a "fairness" measure of damages or not; for a proxy violation "the plaintiff is entitled to restitution" even though "the plan of merger was fair" in the sense that there were no "damages at the time of the sale of the stock." *Gerstle* v. *Gamble-Skogmo, Inc.*, 298 F. Supp. 66, 99-100 (E.D.N.Y. 1969). Even if the exchange appears fair when viewed at the time of transfer, restitution is afforded to deprive the violater of his ill-gotten gains and to redress his unjust enrichment by requiring him to disgorge his subsequent profits as the fruit of his wrong. Thus the First Circuit has said,

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[6] *See also* Securities Act Release No. 3761: "The Commission believes that in mergers, consolidations, transfers of assets and reclassifications of securities of the type which substantially affect the rights of security holders, such security holders are entitled to equivalent protection as that afforded by the registration provisions of the Securities Act of 1933."

"[If] the property is . . . sold to the fraudulent party, future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." *Janigan* v. *Taylor,* 344 F.2d 781, 786 (1st Cir. 1965).

See also Myzel v. *Fields,* 386 F.2d 718, 746-48 (8th Cir. 1967), *cert. denied* 390 U.S. 951 (1968).

The measure of restitutionary damages is of course not necessarily the market value of the stock the minority shareholders were misled into relinquishing, nor value based on the earnings which they were receiving. We do not believe that the examples of possible measures of recovery offered in the Government's brief, 18-19, can be misread as intended to be an exhaustive enumeration, excluding other well-recognized measures. The illustrative mention of earnings as a common benchmark (Gov't. Br. 18), would not of course provide a valid measure in cases where the defendant has controlled the corporation and has been in a position to manipulate earnings to its own advantage. *See* McCormick, Damages §122, p. 457 (1935).

Here respondents admitted to the SEC in the Investment Company Act proceedings that they had exercised

major influence over Auto-Lite affairs since 1960. A. 358-59. With that control they chose to use the corporation's available cash not as working capital nor to achieve diversification as an escape from what respondents regard as the narrow and "fluctuating automotive market" (Resp. Br. 3): instead, they spent $20,000,000 of Auto-Lite's cash to buy its own stock (A. 57), to reduce the publicly-held portion and thus to help to bring their own holdings, as a proportion of the remaining stock, to more than 50%. This majority position was then employed to squeeze out the minority at a price pegged by the respondents. A well-known evil of the conglomerate is the seizure of large cash reserves for the use and benefit of the controlling interest. Against these circumstances, the remarks of the District Judge concerning the adverse effects of conglomerate mergers on the national economic interests carry a special cogency. In the light of these actions of respondents, it is not surprising that under their control "Auto-Lite had the lowest profit to asset ratio of 22 leading auto parts manufacturers." Resp. Br. 4.

In such a case, neither earnings nor market price is a reliable indicator of the true worth of the corporation assets, and book value is the proper measure. *See Developments in the Law: Damages* 1935-1947, 61 HARV. L. REV. 113, 126, 174 (1947). Respondents charge that use of book value is "absurd" (Resp. Br. 23 n. 9), despite the fact that the sale of at least one division of the corporate assets brought *twice* their book value, while the stock's market price stood at less than 75% of book. A. 36-37, 56. And while they insist that earnings afford the only correct measure, they compute the earnings of Mergenthaler by including amortized profit on the purchase of Auto-Lite shares, and measure that profit by the difference between

the market price paid and the higher book value. A. 76. By this device, they raised the stated earnings of Mergenthaler by 14%, to achieve a merger ratio they claim to be "fair". In short, book value is not "absurd" when used to show the merger to be "fair",—but only when it reveals the unfairness of the merger.[7]

To expedite the ultimate disposition of this controversy over respondents' continued insistence that "fairness" must control, this Court should re-affirm its approval of monetary restitution as an appropriate remedy, as already declared in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 434, (1964), clearing the way for a clean-cut and simple

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[7] Gurdon W. Wattles, who dominated the management of Mergenthaler (A. 412-13) and Auto-Lite (A. 415), testified before a Securities and Exchange Commission hearing examiner relative to the merger of three companies in which he had an interest (Century Investors, Inc., Webster Investors, Inc. and American Manufacturing Company) as follows:

"[I]n principle I would say this; that as far as we were concerned, we felt that the predominant factor in determining the relative division of interests in the merged company was based on assets and secondarily on earnings." A. 296.

"[B]asically we felt that the book value of the assets was a more important factor than the earnings. . . . So I would say that we felt that the major consideration should be the book value."

"We have been building these companies on a basis of assets, and we have over a period of years been able to create value through making use of these assets and converting them to better use. We have felt that provided the asset value was good, that for our purposes the asset value was of greater importance in determining this value than the immediate earnings which might not reflect what we felt it was possible to generate." A. 297.

measure of recovery of the violator's unlawful gains at the present true value of the assets unlawfully acquired. No exhaustive war of attrition, waged as a battle of expert opinion on the fairness of merger ratios, will then be required; in this sense, "fairness" is indeed irrelevant.

D. With the Final Adjudication of Liability, Petitioners Are Now Entitled to an Award of Litigation Expenses.

Although the question of final relief is not now ripe for final decision, the District Court has made a definitive disposition of the other issues. Both lower courts have made a final decision on the violation of the securities laws, and that question is closed. With that final decision, the petitioners are entitled at this stage to an award of reasonable litigation expenses incurred for the benefit of their corporation, for the reasons fully put forth by the Government in its brief, pp. 21-24. Reimbursement of such expenses is essential to the utility of the private action as a necessary and "effective weapon in the enforcement of the proxy requirements." *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964).

Because a violation has been finally established, petitioners are also entitled to an interim award for expenses incurred in future proceedings for determination of the appropriate relief, for the reasons fully developed in the brief of the Government, acting as amicus curiae at this Court's invitation. Gov't. Br. 19-21. Respondents' statement (Resp. Br. 32), that none of the authorities "support an interim award of fees" is incorrect. *See, e.g., Highway Truck Drivers & Helpers, Local 107* v. *Cohen*, 220 F. Supp. 735 (E. D. Pa. 1963), *aff'd*, 334 F.2d 378 (3d Cir. 1964), *cert. denied*, 379 U.S. 921 (1964).

III. THE ADMITTED FACT THAT UNLAWFUL PROXY SOLICITATION PRODUCED VOTES ESSENTIAL TO MERGER ESTABLISHES THE REQUIRED CAUSAL RELATIONSHIP.

Respondents make no serious attempt to defend or to support the decision of the Court of Appeals on the only aspect of the case now properly before this Court for final decision. On that single issue of causation, the rationale of the opinion here under review is not even stated in respondents' brief. An uninformed reader of that brief might well be led to the impression that the Court of Appeals had made some casual and off-hand remarks in passing about "misplaced emphasis" in proxy materials and about the niceties of typographical style and the usage of bold-faced type,* but that it had then proceeded to hold generally that liability was not established, and to remand for a general trial of all the relevant but unspecified "surrounding circumstances." That is not this case. The Court of Appeals devoted a major portion of its opinion, and its most careful attention, to the unequivocal holding that respondents' proxy statement, viewed as a whole, was materially misleading in violation of federal law. That holding was the predicate and founda-

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*This Court has recognized in other contexts that type sizes, bold-face print, and composition may produce a misleading effect. *Donaldson* v. *Read Magazine, Inc.*, 333 U.S. 178, 188-89 (1948):

> "Advertisements as a whole may be completely misleading although every sentence separately considered is literally true. This may be because things are omitted that should be said, or because advertisements are composed or purposefully printed in such way as to mislead. . . . Questions of fraud may be determined in the light of the effect advertisements would most probably produce on ordinary minds."

tion for imposing upon respondents the burden of proof in further proceedings on the question of liability, confined to causation alone. Under that decision, it would not be open to the trial judge on remand to conclude that the proxy statement made adequate disclosure or that its misstatements and omissions were trivial, immaterial, or purely technical. The doctrine of the Law of the Case would allow him to find no liability only by finding that the proxy statement did not "cause" the merger. Since respondents did not see fit to ask this Court to hear its objections to the decision on their violation, the Court of Appeals' judgment must stand or fall on the correctness of its decision on the question of causation.

Respondents' repeated assertion that there must be a vague and directionless trial of "all the relevant surrounding circumstances" before liability can be determined has no bearing on any issue before the Court. The term "circumstances"[9] is borrowed from Rule 14a-9, which defines the violation, not causation. The "circumstances" enumerated at page 20 and again at page 36 of their brief were all either fully considered by both courts below to the

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[9] Respondents' truncated quotation of Rule 14a-9 is the basis for their argument that "circumstances" surrounding the "proxy statement" are relevant to whether a violation was committed. They have parsed the Rule incorrectly. It is a "statement" contained *in* the proxy statement which is to be read in the light of its circumstances, that is, the other disclosures contained elsewhere in the proxy statement, and the external facts which determine its truth or falsity. "Circumstances" not revealed in the proxy statement cannot cure its misleading contents. The full Rule is set forth at page 3 of Petitioners' Brief.

extent that they relate to the violation,[10] or remain to be considered in the future to the extent that they concern the relief to be granted.[11] Thus the courts below have fully considered all their enumerated "circumstances" bearing on the causal relationship. The "attractiveness of the merger" (Resp. Br. 20, 36) has no relevance to the question of causation, for the reasons presented in Petitioners' Brief, *passim*. Respondents do not undertake to meet those reasons, nor to follow the Court of Appeals' tortuous conversion of causation into reliance into fairness. They ignore the fact that Congress eliminated reliance in the statutory scheme because "To encourage reliance we must dispense with its proof." Fuller and Perdue, *The Reliance Interest in Contract Damages: 1*, 46 YALE L.J. 52, 62 (1936).

Although they insist there should be a trial on "the percentage of the vote needed[12] and received" (Resp. Br. 20), respondents make no reference to the District Court's detailed findings of the undisputed facts on those "circum-

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[10] In this category are "the gravity of the omission" and "the nature of the matter being voted upon" (Resp. Br. 20), and "the disclosures which were made" and the unsupported and off-the-record "SEC's clearance of the proxy statement." Resp. Br. 36.

[11] In this category are "the interests of innocent third parties," the "stage of transaction at which relief is sought," Resp. Br. 20, and "deliberate delay," Resp, Br. 36.

[12] Respondents' statement that "96% of the shareholders voting favored the merger," Resp. Br. 8, takes on a very different meaning in light of the fact that a failure to vote constituted a negative vote. In fact, fewer than two-thirds of the minority shareholdings favored the merger, and the merger could not have been approved without the self-dealing votes of the shares owned by respondents, the adversary in the transaction. Under these circumstances, it can scarcely be said that the "Auto-Lite shareholders overwhelmingly approved . . . ." Resp. Br. 21.

stances." A. 687-88. They contradict this assertion that summary judgment was improper without a trial on these matters, however, by saying now that the facts were "never contested." Resp. Br. 10.[13]

It is thus undisputed and conceded that votes produced by the unlawful proxy solicitation were essential to approval of the merger. The "causal relationship of the proxy material and the merger," *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 431 (1964), is established by the uncontradicted and uncontroverted facts, and summary judgment was properly entered in the absence of any genuine controversy on any fact material to the issue. The reference in the *Borak* opinion to this issue as a question of "fact to be resolved at the trial, not here" (377 U.S. at 431), was not intended to forbid summary judgment or to require a useless trial of undisputed fact. That case came before this Court at the pleading stage, and the quoted language merely embodies the Court's refusal to decide a fact question on pleading recitals.

Causation in fact is uncontested. As the Government cogently submits, the District Court's "objective test is not only practical and workable, but will serve to effectuate the underlying purposes of the proxy rules." Gov't Br. 14-15. Nothing more can be required in consonance with "the duty of the courts to be alert to provide such remedies

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[13] The statement that respondents "never contested" these facts is difficult to reconcile with their persistent refusal to admit them in response to petitioners' requests to admit under Rule 35. A. 467-503. These objections and refusals forced petitioners to resort to a motion to produce the minutes and attendance records of the shareholder meeting, in order to establish the facts "never contested." A. 505-521. Even then, respondents' objections forced petitioners' counsel to travel to Ohio to examine the documents. A. 521.

as are necessary to make effective the congressional purpose." *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433 (1964). The view of the Court of Appeals that causation would not exist if there were a preponderance of probability that the merger might still have been approved with a truthful proxy statement, A. 1013, is of doubtful vitality even as the rule obtaining in the Seventh Circuit. In *Swanson* v. *American Consumer Industries, Inc.*, C.C.H. Fed. Sec. L. Rep. ¶ 92, 458 (7th Cir. August 13, 1969), another panel of the court has subsequently declined to hold that causation was lacking even though the defendants owned 87% of the stock, more than enough to approve the merger, and even though it could thus be said with confidence that the merger would still have received a favorable vote with a truthful proxy statement.

CONCLUSION

For the foregoing reasons, the portions of Respondents' Brief dealing with their violation of the securities laws and seeking reversal of the Court of Appeals' judgment on that issue must be disregarded. The judgment of the Court of Appeals on the issue of causation should be vacated, and the judgment of the District Court should be affirmed.

Respectfully submitted,

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November 5, 1969.

APPENDIX

Outline of Argument
on
ISSUES BEYOND THE SCOPE OF THE PETITION FOR CERTIORARI

Full argument on these issues argued by respondents will be presented upon request of the Court.

INTRODUCTION: Factual errors and inaccuracies in Respondents' Statement of the Case.

I. UPON THE EVIDENCE, THE COURT OF APPEALS PROPERLY HELD THAT RESPONDENTS' PROXY STATEMENT VIOLATED THE PROXY RULES IN URGING THE AUTO-LITE DIRECTORS' RECOMMENDATION WITHOUT DISCLOSING THEIR RELATION TO MERGENTHALER.

A. The violation found by the Court of Appeals was not a failure to disclose the percentage of stock owned by respondents, but the failure to disclose that all the Auto-Lite directors were nominees of Mergenthaler, selected and deputed to serve the best interests of Mergenthaler.

B. Mere statement of the percentage of stock ownership did not constitute full and frank disclosure of domination through selection of all of Auto-Lite's directors and working control of its business management, as adjudicated by the SEC in proceedings under the Investment Company Act.

C. Beyond non-disclosure, the proxy statement was affirmatively false in stating, under the heading "Interests of Certain Persons in Matters To Be Acted Upon at the Meeting", that, apart from the four interlocking directors, "no director . . . has any substantial interest, direct or indirect, in any matter to be acted upon at the meeting . . . ."

D. Under *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), a fiduciary giving investment advice must disclose all facts creating a conflict of interest with a potential for abuse.

E. As representatives of the minority shareholders' adversary in the merger transaction, the Auto-Lite directors could not lawfully advise and recommend stockholder approval without disclosing their conflict-of-interest position, to allow the shareholders to evaluate for themselves the disinterestedness of the advice.

II. RESPONDENTS WERE ALSO GUILTY OF A *PER SE* VIOLATION OF THE PROXY RULES, UNNECESSARY FOR THE COURT OF APPEALS TO CONSIDER, IN FAILING TO DISCLOSE THAT CANDIDATES FOR THE BOARD OF DIRECTORS OF THE NEW CORPORATION WERE SUBJECT TO AN ARRANGEMENT AND UNDERSTANDING WITH A THIRD CORPORATION.

A. Since Mergenthaler directors would become directors of the merged corporation, the Auto-Lite shareholders were in fact electing them in voting on the merger, and were entitled to information bearing on their conflicts of interest.

B. The Mergenthaler directors were nominees of American, selected and deputed to represent its interests, and continuation of that arrangement and understanding was essential to American's exemption under the Investment Company Act.

C. The proxy rules explicitly and specifically required disclosure of this arrangement and understanding, and nondisclosure constituted a violation without any necessity for a finding that the omission was materially misleading.

D. The recital that American owned 33% of the Mergenthaler stock did not constitute full and fair disclosure of the arrangement and understanding whereby all Mergenthaler directors were nominees of American, selected and deputed to represent its interests.

III. A MERGER EFFECTUATED THROUGH A VIOLATION OF THE PROXY RULES GIVES RISE TO A FEDERAL CAUSE OF ACTION, AND A RIGHT TO APPROPRIATE RELIEF, IN FAVOR OF THE DEFRAUDED CORPORATION AND ITS SHAREHOLDERS WITHOUT REGARD TO THE UNFAIRNESS OF THE MERGER TERMS, FINANCIAL INJURY, OR OTHER ELEMENTS OF A COMMON LAW CAUSE OF ACTION.

IV. HONEST MOTIVES, GOOD FAITH, AND THE SOUNDNESS OF THE ADVICE DO NOT EXCUSE NONDISCLOSURE OF AN ADVISER'S CONFLICT OF INTEREST.

V. FAILURE OF THE SEC TO OBJECT TO A PROXY STATEMENT FILED WITH IT DOES NOT CONSTITUTE SEC APPROVAL, AND IS ENTITLED TO NO WEIGHT IN JUDICIAL PROCEEDINGS.

A. In view of the SEC's limitations of staff, time, and investigative facilities, its failure to take action against proxy materials carries no implication of approval, and Congress has explicitly forbidden any such implication in Section 26 of the Securities Exchange Act of 1934.

B. Within the realities of agency operation, it cannot be presumed that SEC staff members in the office of Corporate Analysis and Examination of the

Division of Corporation Finance, in reviewing the proxy statement, had knowledge of facts contained in the files of another proceeding, under a different corporate name, in the office of Investment Company Regulation in the Division of Corporate Regulation.

VI. SINCE THE FACTS OMITTED FROM THE PROXY STATEMENT WERE OFFICIALLY ADJUDICATED BY THE SEC AND ADMITTED BY RESPONDENTS TO BE TRUE, PARTIAL SUMMARY JUDGMENT ON THE ISSUE OF THE VIOLATION WAS PROPERLY ENTERED.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 64.—October Term, 1969

Elmer E. Mills and Louis Susman, Petitioners, *v.* The Electric Auto-Lite Company et al. | On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[January 20, 1970]

Mr. Justice Harlan delivered the opinion of the Court.

This case requires us to consider a basic aspect of the implied private right of action for violation of § 14 (a) of the Securities Exchange Act of 1934,[1] recognized by this Court in *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964). As in *Borak* the lower courts have found that a corporate merger was accomplished through the use of a proxy statement that was materially false or misleading. The question with which we deal is what causal relationship must be shown between such a statement and the merger to establish a cause of action based on the violation of the Act.

I

Petitioners were shareholders of the Electric Auto-Lite Company until 1963, when it was merged into Mergenthaler Linotype Company. They brought suit on the day before the shareholders' meeting at which the vote was to take place on the merger, against Auto-Lite, Mergenthaler, and a third company, American Manufacturing Company, Inc. The complaint sought an

[1] As amended, 15 U. S. C. § 78n (a).

injunction against the voting by Auto-Lite's management of all proxies obtained by means of an allegedly misleading proxy solicitation; however, it did not seek a temporary restraining order, and the voting went ahead as scheduled the following day. Several months later petitioners filed an amended complaint, seeking to have the merger set aside and to obtain such other relief as might be proper.

In Count II of the amended complaint, which is the only count before us,[2] petitioners predicated jurisdiction on § 27 of the 1934 Act, 15 U. S. C. § 78aa. They alleged that the proxy statement sent out by the Auto-Lite management to solicit shareholders' votes in favor of the merger was misleading, in violation of § 14 (a) of the Act and Rule 14a–9 thereunder. Petitioners recited that before the merger Mergenthaler owned over 50% of the outstanding shares of Auto-Lite common stock, and had been in control of Auto-Lite for two years. American Manufacturing in turn owned about one-third of the outstanding shares of Mergenthaler, and for two years had been in voting control of Mergenthaler and, through it, of Auto-Lite. Petitioners charged that in light of these circumstances the proxy statement was misleading in that it told Auto-Lite shareholders that their board of directors recommended approval of the merger without also informing them that all 11 of Auto-Lite's directors were nominees of Mergenthaler and were under the "control and domination of Mergenthaler." Petitioners asserted the right to complain of this alleged violation both derivatively on behalf of Auto-Lite and as representatives of the class of all its minority shareholders.

On petitioners' motion for summary judgment with respect to Count II, the District Court for the Northern

[2] In the other two counts, petitioners alleged common-law fraud and that the merger was *ultra vires* under Ohio law.

District of Illinois ruled as a matter of law that the claimed defect in the proxy statement was, in light of the circumstances in which the statement was made, a material omission. The District Court concluded, from its reading of the *Borak* opinion, that it had to hold a hearing on the issue whether there was "a causal connection between the finding that there has been a violation of the disclosure requirements of § 14 (a) and the alleged injury to the plaintiffs" before it could consider what remedies would be appropriate. (Unreported opinion dated February 14, 1966.)

After holding such a hearing, the court found that under the terms of the merger agreement, an affirmative vote of two-thirds of the Auto-Lite shares was required for approval of the merger, and that the respondent companies owned and controlled about 54% of the outstanding shares. Therefore, to obtain authorization of the merger, respondents had to secure the approval of a substantial number of the minority shareholders. At the stockholders' meeting, approximately 950,000 shares, out of 1,160,000 shares outstanding, were voted in favor of the merger. This included 317,000 votes obtained by proxy from the minority shareholders, votes that were "necessary and indispensable to the approval of the merger." The District Court concluded that a causal relationship had thus been shown, and it granted an interlocutory judgment in favor of petitioners on the issue of liability, referring the case to a master for consideration of appropriate relief. 281 F. Supp. 826 (1967).

The District Court made the certification required by 28 U. S. C. § 1292 (b), and respondents took an interlocutory appeal to the Court of Appeals for the Seventh Circuit.[3] That court affirmed the District Court's con-

[3] Petitioners cross-appealed from an order entered by the District Court two days after its summary judgment in their favor, deleting from that judgment a conclusion of law that "[u]nder the provisions

clusion that the proxy statement was materially deficient, but reversed on the question of causation. The court acknowledged that, if an injunction had been sought a sufficient time before the stockholders' meeting, "corrective measures would have been appropriate." 403 F. 2d 429, 435 (1969). However, since this suit was brought too late for preventive action, the courts had to determine "whether the misleading statement and omission caused the submission of sufficient proxies," as a prerequisite to a determination of liability under the Act. If the respondents could show, "by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found," petitioners would be entitled to no relief of any kind.

The Court of Appeals acknowledged that this test corresponds to the common-law fraud test of whether the injured party relied on the misrepresentation. However, rightly concluding that "reliance by thousands of individuals, as here, can scarcely be inquired into," the court ruled that the issue was to be determined by proof of the fairness of the terms of the merger. If respondents could show that the merger had merit and was fair to the minority shareholders, the trial court would be justified in concluding that a sufficient number of shareholders would have approved the merger had there been no deficiency in the proxy statement. In that case respondents would be entitled to a judgment in their favor.

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of Section 29 (b) of the Securities Exchange Act of 1934, the merger effectuated through a violation of Section 14 of the Act is void." This deletion was apparently made for the purpose of avoiding any prejudice on the question of relief, which remained open for consideration by the master. In light of its disposition of respondents' appeal, the Court of Appeals had no need to consider the cross-appeal.

Claiming that the Court of Appeals has construed this Court's decision in *Borak* in a manner that frustrates the statute's policy of enforcement through private litigation, the petitioners then sought review in this Court. We granted certiorari, 394 U. S. 971 (1969), believing that resolution of this basic issue should be made at this stage of the litigation and not postponed until after a trial under the Court of Appeals' decision.[4]

II

As we stressed in *Borak*, § 14 (a) stemmed from a congressional belief that "[f]air corporate suffrage is an important right that should attach to every security bought on a public exchange." H. R. Rep. No. 1383, 73d Cong., 2d Sess., 13. The provision was intended to promote "the free exercise of the voting rights of stockholders" by ensuring that proxies would be solicited with "explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought." *Id.*, at 14; S. Rep. No. 792, 73d Cong., 2d Sess., 12; see 377 U. S., at 431. The decision below, by permitting all liability to be foreclosed on the basis of a finding that the merger was fair, would allow the stockholders to be bypassed, at least where the only legal challenge to the merger is a suit for retrospective relief after the meeting has been held. A judicial appraisal of the merger's merits could be substituted for the actual and informed vote of the stockholders.

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[4] Respondents ask this Court to review the conclusion of the lower courts that the proxy statement was misleading in a material respect. Petitioners naturally did not raise this question in their petition for certiorari, and respondents filed no cross-petition. In these circumstances we will not consider the question. See *J. I. Case Co.* v. *Borak*, 377 U. S., at 426–427, and authorities there cited; R. Stern & E. Gressman, Supreme Court Practice 298 (4th ed. 1969).

The result would be to insulate from private redress an entire category of proxy violations—those relating to matters other than the terms of the merger. Even outrageous misrepresentations in a proxy solicitation, if they did not relate to the terms of the transaction, would give rise to no cause of action under § 14 (a). Particularly if carried over to enforcement actions by the Securities and Exchange Commission itself, such a result would subvert the congressional purpose of ensuring full and fair disclosure to shareholders.

Further, recognition of the fairness of the merger as a complete defense would confront small shareholders with an additional obstacle to making a successful challenge to a proposal recommended through a defective proxy statement. The risk that they would be unable to rebut the corporation's evidence of the fairness of the proposal, and thus to establish their cause of action, would be bound to discourage such shareholders from the private enforcement of the proxy rules that "provides a necessary supplement to Commission action." *J. I. Case Co.* v. *Borak*, 377 U. S., at 432.[5]

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[5] The Court of Appeals' ruling that "causation" may be negated by proof of the fairness of the merger also rests on a dubious behavioral assumption. There is no justification for presuming that the shareholders of every corporation are willing to accept any and every fair merger offer put before them; yet such a presumption is implicit in the opinion of the Court of Appeals. That court gave no indication of what evidence petitioners might adduce, once respondents had established that the merger proposal was equitable, in order to show that the shareholders would nevertheless have rejected it if the solicitation had not been misleading. Proof of actual reliance by thousands of individuals would, as the court acknowledged, not be feasible, see R. Jennings & H. Marsh, Cases on Securities Regulation 1001 (2d ed. 1968); and reliance on the *nondisclosure* of a fact is a particularly difficult matter to define or prove, see 3 L. Loss, Securities Regulation 1766 (2d ed. 1961). In practice, therefore, the objective fairness of the proposal would

Such a frustration of the congressional policy is not required by anything in the wording of the statute or in our opinion in the *Borak* case. Section 14 (a) declares it "unlawful" to solicit proxies in contravention of Commission rules, and SEC Rule 14a–9 prohibits solicitations "containing any statement which . . . is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading . . . ." Use of a solicitation which is materially misleading is itself a violation of law, as the Court of Appeals recognized in stating that injunctive relief would be available to remedy such a defect if sought prior to the stockholders' meeting. In *Borak*, which came to this Court on a dismissal of the complaint, the Court limited its inquiry to whether a violation of § 14 (a) gives rise to "a federal cause of action for rescission or damages," 377 U. S., at 428. Referring to the argument made by defendants there "that the merger can be dissolved only if it was fraudulent or non-beneficial, issues upon which the proxy material would not bear," the Court stated: "But the causal relationship of the proxy material and the merger are questions of fact to be resolved at trial, not here. We therefore do not discuss this point further." *Id.*, at 431. In the present case there has been a hearing specifically directed to the causation problem. The question before the Court is whether the facts found on the basis of that hearing are sufficient in law to establish petitioners' cause of action, and we conclude that they are.

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seemingly be determinative of liability. But, in view of the many other factors that might lead shareholders to prefer their current position to that of owners of a larger, combined enterprise, it is pure conjecture to assume that the fairness of the proposal will always be determinative of their vote. Cf. *Wirtz* v. *Hotel, Motel & Club Employees Union*, 391 U. S. 492, 508 (1968).

Where the misstatement or omission in a proxy statement has been shown to be "material," as it was found to be here, that determination itself indubitably embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote.[6] This requirement that the defect have a significant *propensity* to affect the voting process is found in the express terms of Rule 14a–9, and it adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14 (a).

There is no need to supplement this requirement, as did the Court of Appeals, with a requirement of proof

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[6] Cf. *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 462 (C. A. 2d Cir. 1965); *General Time Corp.* v. *Talley Industries, Inc.*, 403 F. 2d 159, 162 (C. A. 2d Cir. 1968); Restatement (Second) of Torts § 538 (2)(a) (Tent. Draft No. 10, 1964); 2 L. Loss, Securities Regulation 917 (2d ed. 1961); 6 *id.*, at 3534 (Supp. to 2d ed. 1969).

In this case, where the misleading aspect of the solicitation involved failure to reveal a serious conflict of interest on the part of the directors, the Court of Appeals concluded that the crucial question in determining materiality was "whether the minority shareholders were sufficiently alerted to the board's relationship to their adversary to be on their guard." 403 F. 2d, at 434. An adequate disclosure of this relationship would have warned the stockholders to give more careful scrutiny to the terms of the merger than they might to one recommended by an entirely disinterested board. Thus, the failure to make such a disclosure was found to be a material defect "as a matter of law," thwarting the informed decision at which the statute aims, regardless of whether the terms of the merger were such that a reasonable stockholder would have approved the transaction after more careful analysis. See also *Swanson* v. *American Consumer Industries, Inc.*, 415 F. 2d 1326 (C. A. 7th Cir. 1969).

of whether the defect actually had a decisive effect on the voting. Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction. This objective test will avoid the impracticalities of determining how many votes were affected, and, by resolving doubts in favor of those the statute is designed to protect, will effectuate the congressional policy of ensuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions. Cf. *Union Pac. R. Co.* v. *Chicago & N. West. Ry.*, 226 F. Supp. 400, 411 (D. C. N. D. Ill. 1964); 2 L. Loss, Securities Regulation 962, n. 411 (2d ed. 1961); 5 *id.*, at 2929–2930 (Supp. to 2d ed. 1969).[7]

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[7] We need not decide in this case whether causation could be shown where the management controls a sufficient number of shares to approve the transaction without any votes from the minority. Even in that situation, if the management finds it necessary for legal or practical reasons to solicit proxies from minority shareholders, at least one court has held that the proxy solicitation might be sufficiently related to the merger to satisfy the causation requirement, see *Laurenzano* v. *Einbender*, 264 F. Supp. 356 (D. C. E. D. N. Y. 1966); cf. *Swanson* v. *American Consumer Industries, Inc.*, 415 F. 2d 1326, 1331–1332 (C. A. 7th Cir. 1969); *Eagle* v. *Horvath*, 241 F. Supp. 341, 344 (D. C. S. D. N. Y. 1965); *Globus, Inc.* v. *Jaroff*, 271 F. Supp. 378, 381 (D. C. S. D. N. Y. 1967); Comment, Shareholders' Derivative Suit to Enforce a Corporate Right of Action Against Directors Under SEC Rule 10b-5, 114 U. Pa. L. Rev. 578, 582 (1966). But see *Hoover* v. *Allen*, 241 F. Supp. 213, 231–232 (D. C. S. D. N. Y. 1965); *Barnett* v. *Anaconda Co.*, 238 F. Supp. 766, 770–774 (D. C. S. D. N. Y. 1965); *Robbins* v. *Banner Industries, Inc.*, 285 F. Supp. 758, 762–763 (D. C. S. D. N. Y. 1966). See generally 5 L. Loss, Securities Regulation 2933–2938 (Supp. to 2d ed. 1969).

III

Our conclusion that petitioners have established their case by showing that proxies necesary to approval of the merger were obtained by means of a materially misleading solicitation implies nothing about the form of relief to which they may be entitled. We held in *Borak* that upon finding a violation the courts were "to be alert to provide such remedies as are necessary to make effective the congressional purpose," noting specifically that such remedies are not to be limited to prospective relief. 377 U. S., at 433, 434. In devising retrospective relief for violation of the proxy rules, the federal courts should consider the same factors that would govern the relief granted for any similar illegality or fraud. One important factor may be the fairness of the terms of the merger. Possible forms of relief will include setting aside the merger or granting other equitable relief, but, as the Court of Appeals below noted, nothing in the statutory policy "requires the court to unscramble a corporate transaction merely because a violation occurred." 403 F. 2d, at 436. In selecting a remedy the lower courts should exercise "the sound discretion which guides the determinations of courts of equity," keeping in mind the role of equity as "the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims." *Hecht Co.* v. *Bowles*, 321 U. S. 321, 329–330 (1944).

We do not read § 29 (b) of the Act,[8] which declares contracts made in violation of the Act or a rule there-

[8] Section 29 (b) provides in pertinent part: "Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder . . . shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made . . . any such contract, and (2) as regards the

under "void . . . as regards the rights of" the violator and knowing successors in interest, as requiring that the merger be set aside simply because the merger agreement is a "void" contract. This language establishes that the guilty party is precluded from enforcing the contract against an unwilling innocent party,[9] but it does not compel the conclusion that the contract is a nullity, creating no enforceable rights even in a party innocent of the violation. The lower federal courts have read § 29 (b), which has counterparts in the Holding Company Act, the Investment Company Act, and the Investment Advisers Act,[10] as rendering the contract merely voidable at the option of the innocent party. See, *e. g.*, *Greater Iowa Corp.* v. *McLendon*, 378 F. 2d 783, 792 (C. A. 8th Cir. 1967); *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210, 213 (C. A. 9th Cir. 1962); *Bankers Life & Cas. Co.* v. *Bellanca Corp.*, 288 F. 2d 784, 787 (C. A. 7th Cir. 1961); *Kaminsky* v. *Abrams*, 281 F. Supp. 501, 507 (D. C. S. D. N. Y. 1968); *Maher* v. *J. R. Williston & Beane, Inc.*, 280 F. Supp. 133, 138–139 (D. C. S. D. N. Y. 1967); cf. *Green* v. *Brown*, 276 F. Supp. 753, 757 (D. C. S. D. N. Y. 1967), remanded on other grounds, 398 F. 2d 1006 (C. A. 2d Cir. 1968) (Investment Company Act). See also 5 L. Loss, *supra*, at 2925–2926 (Supp. to 2d ed. 1969); 6 *id.*, at 3866.

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rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making . . . of such contract was in violation of any such provision, rule, or regulation . . . ." 15 U. S. C. § 78cc (b).

[9] See *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F. 2d 357, 362–363 (C. A. 5th Cir. 1968); cf. *Goldstein* v. *Groesbeck*, 142 F. 2d 422, 426–427 (C. A. 2d Cir. 1944).

[10] See Public Utility Holding Company Act of 1935, § 26 (b), 15 U. S. C. § 79z (b); Investment Company Act of 1940, § 47 (b), 15 U. S. C. § 80a–46 (b); Investment Advisers Act of 1940, § 215 (b), 15 U. S. C. § 80b–15 (b).

This interpretation is eminently sensible. The interests of the victim are sufficiently protected by giving him the right to rescind; to regard the contract as void where he has not invoked that right would only create the possibility of hardships to him or others without necessarily advancing the statutory policy of disclosure.

The United States, as *amicus curiae*, points out that as representatives of the minority shareholders, petitioners are not parties to the merger agreement and thus do not enjoy a statutory right under § 29 (b) to set it aside.[11] Furthermore, while they do have a derivative right to invoke Auto-Lite's status as a party to the agreement, a determination of what relief should be granted in Auto-Lite's name must hinge on whether setting aside the merger would be in the best interests of the shareholders as a whole. In short, in the context of a suit such as this one, § 29 (b) leaves the matter of relief where it would be under *Borak* without specific statutory language—the merger should be set aside only if a court of equity concludes, from all the circumstances, that it would be equitable to do so. Cf. *SEC* v. *National Securities, Inc.*, 393 U. S. 453, 456, 463–464 (1969).

Monetary relief will, of course, also be a possibility. Where the defect in the proxy solicitation relates to the specific terms of the merger, the district court might appropriately order an accounting to ensure that the shareholders receive the value that was represented as coming to them. On the other hand, where, as here, the

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[11] If petitioners had submitted their own proxies in favor of the merger in response to the unlawful solicitation, as it does not appear they did, the language of § 29 (b) would seem to give them, as innocent parties to that transaction, a right to rescind their proxies. But it is clear in this case, where petitioners' combined holdings are only 600 shares, that such rescission would not affect the authorization of the merger.

misleading aspect of the solicitation did not relate to terms of the merger, monetary relief might be afforded to the shareholders only if the merger resulted in a reduction of the earnings or earnings potential of their holdings. In short, damages should be recoverable only to the extent that they can be shown. If commingling of the assets and operations of the merged companies makes it impossible to establish direct injury from the merger, relief might be predicated on a determination of the fairness of the terms of the merger at the time it was approved. These questions, of course, are for decision in the first instance by the District Court on remand, and our singling out of some of the possibilities is not intended to exclude others.

IV

Although the question of relief must await further proceedings in the District Court, our conclusion that petitioners have established their cause of action indicates that the Court of Appeals should have affirmed the partial summary judgment on the issue of liability.[12] The result would have been not only that respondents, rather than petitioners, would have borne the costs of the appeal, but, we think, that petitioners would have been entitled to an interim award of litigation expenses and reasonable attorneys' fees. Cf. *Highway Truck Drivers Local 107* v. *Cohen*, 220 F. Supp. 735 (D. C. E. D. Pa. 1963). We agree with the position taken by petitioners, and by the United States as *amicus*, that petitioners, who have established a violation of the

[12] The Court of Appeals might have modified the judgment of the District Court to the extent that it referred the issue of relief to a master under Fed Rule Civ. Proc. 53 (b). The Court of Appeals' opinion indicates doubt whether the referral was appropriate, 403 F. 2d, at 436, and this issue is not before us.

securities laws by their corporation and its officials, should be reimbursed by the corporation or its survivor for the costs of establishing the violation.[13]

The absence of express statutory authorization for an award of attorneys' fees in a suit under § 14 (a) does not preclude such an award in cases of this type. In a suit by stockholders to recover short-swing profits for their corporation under § 16 (b) of the 1934 Act, the Court of Appeals for the Second Circuit has awarded attorneys' fees despite the lack of any provision for them in § 16 (b), "on the theory that the corporation which has received the benefit of the attorney's services should pay the reasonable value thereof." *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 241 (C. A. 2d Cir. 1943). The court held that Congress' inclusion in §§ 9 (e) and 18 (a) of the Act of express provisions for recovery of attorneys' fees in certain other types of suits [14] "does not impinge the result we reach in the absence of statute, for those sections merely enforce an additional penalty against the wrongdoer." *Id.*, at 242.

We agree with the Second Circuit that the specific provisions in §§ 9 (e) and 18 (a) should not be read as

[13] We believe that the question of reimbursement for these expenses has a sufficiently close relationship to the determination of what constitutes a cause of action under § 14 (a) that it is appropriate for decision at this time. The United States urges the Court to consider also whether petitioners will be entitled to recoup expenses reasonably incurred in further litigation on the question of relief. We are urged to hold that such expenses should be reimbursed regardless of whether petitioners are ultimately successful in obtaining significant relief. However, the question of reimbursement for future expenses should be resolved in the first instance by the lower courts after the issue of relief has been litigated and a record has been established concerning the need for a further award. We express no view on the matter at this juncture.

[14] These provisions deal, respectively, with manipulation of security prices and with misleading statements in documents filed with the Commission. See 15 U. S. C. §§ 78i (e), 78r (a).

denying to the courts the power to award counsel fees in suits under other sections of the Act when circumstances make such an award appropriate, any more than the express creation by those sections of private liabilities negates the possibility of an implied right of action under § 14 (a). The remedial provisions of the 1934 Act are far different from those of the Lanham Act, which have been held to preclude an award of attorneys' fees in a suit for trademark infringement. *Fleischmann Corp.* v. *Maier Brewing Co.*, 386 U. S. 715 (1967). Since Congress in the Lanham Act had "meticulously detailed the remedies available to a plaintiff who proves that his valid trademark has been infringed," the Court in *Fleischmann* concluded that the express remedial provisions were intended "to mark the boundaries of the power to award monetary relief in cases under the Act." 386 U. S., at 721. By contrast, we cannot fairly infer from the Securities Exchange Act of 1934 a purpose to circumscribe the courts' power to grant appropriate remedies. Cf. *Bakery Workers Union* v. *Ratner*, 335 F. 2d 691, 696–697 (C. A. D. C. Cir. 1964). The Act makes no provision for private recovery for a violation of § 14 (a), other than the declaration of "voidness" in § 29 (b), leaving the courts with the task, faced by this Court in *Borak*, of deciding whether a private right of action should be implied. The courts must similarly determine whether the special circumstances exist that would justify an award of attorneys' fees, including reasonable expenses of litigation other than statutory costs.[15]

While the general American rule is that attorneys' fees are not ordinarily recoverable as costs, both the courts and Congress have developed exceptions to this rule for situations in which overriding considerations

[15] Cf. Note, Attorney's Fees: Where Shall the Ultimate Burden Lie? 20 Vand. L. Rev. 1216, 1229 and n. 68 (1967).

indicate the need for such a recovery.[16] A primary judge-created exception has been to award expenses where a plaintiff has successfully maintained a suit, usually on behalf of a class, that benefits a group of others in the same manner as himself. See *Fleischmann Corp.* v. *Maier Brewing Co.*, 386 U. S., at 718–719. To allow the others to obtain full benefit from the plaintiff's efforts without contributing equally to the litigation expenses would be to enrich the others unjustly at the plaintiff's expense. This suit presents such a situation. The dissemination of misleading proxy solicitations was a "deceit practiced on the stockholders as a group," *J. I. Case Co.* v. *Borak*, 377 U. S., at 432, and the expenses of petitioners' lawsuit have been incurred for the benefit of the corporation and the other shareholders.

The fact that this suit has not yet produced, and may never produce, a monetary recovery from which the fees could be paid does not preclude an award based on this rationale. Although the earliest cases recognizing a right to reimbursement involved litigation that had produced or preserved a "common fund" for the benefit of a group, nothing in these cases indicates that the suit must actually bring money into the court as a prerequisite to the court's power to order reimbursement of expenses.[17] "[T]he foundation for the historic

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[16] Many commentators have argued for a more thoroughgoing abandonment of the rule. See, *e. g.*, Ehrenzweig, Reimbursement of Counsel Fees and the Great Society, 54 Calif. L. Rev. 792 (1966); Kuenzel, The Attorney's Fee: Why Not a Cost of Litigation? 49 Iowa L. Rev. 75 (1963); McCormick, Counsel Fees and Other Expenses of Litigation as an Element of Damages, 15 Minn. L. Rev. 619 (1931); Stoebuck, Counsel Fees Included in Costs: A Logical Development, 38 Colo. L. Rev. 202 (1966); Note, *supra*, n. 15.

[17] See *Trustees* v. *Greenough*, 105 U. S. 527, 531–537 (1882); *Central R. R. & Banking Co.* v. *Pettus*, 113 U. S. 116 (1885);

practice of reimbursement for the costs of litigation other than the conventional taxable costs is part of the original authority of the chancellor to do equity in a particular situation." *Sprague* v. *Ticonic Nat'l Bank*, 307 U. S. 161, 166 (1939). This Court in *Sprague* upheld the District Court's power to grant reimbursement for a plaintiff's litigation expenses even though she had sued only on her own behalf and not for a class, because her success would have a *stare decisis* effect entitling others to recover out of specific assets of the same defendant. Although those others were not parties before the Court, they could be forced to contribute to the costs of the suit by an order reimbursing the plaintiff from the defendant's assets out of which their recoveries later would have to come. The Court observed that "the absence of an avowed class suit or the creation of a fund, as it were, through *stare decisis* rather than through a decree—hardly touch the power of equity in doing justice as between a party and the beneficiaries of his litigation." *Id.*, at 167.

Other cases have departed further from the traditional metes and bounds of the doctrine, to permit reimbursement in cases where the litigation has conferred a sub-

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Hornstein, The Counsel Fee in Stockholder's Derivative Suits, 39 Col. L. Rev. 784 (1939).

Even in the original "fund" case in this Court, it was recognized that the power of equity to award fees was not restricted to the court's ability to provide reimbursement from the fund itself: "It would be very hard on [the successful plaintiff] to turn him away without any allowance. . . . It would not only be unjust to him, but it would give to the other parties entitled to participate in the benefits of the fund an unfair advantage. He has worked for them as well as for himself; and if he cannot be reimbursed out of the fund itself, they ought to contribute their due proportion of the expenses, which he has fairly incurred. To make them a charge upon the fund is the most equitable way of securing such contribution." *Trustees* v. *Greenough*, 105 U. S., at 532.

stantial benefit on the members of an ascertainable class, and where the court's jurisdiction over the subject matter of the suit makes possible an award that will operate to spread the costs proportionately among them. This development has been most pronounced in shareholders' derivative actions, where the courts increasingly have recognized that the expenses incurred by one shareholder in the vindication of a corporate right of action can be spread among all shareholders through an award against the corporation, regardless of whether an actual money recovery has been obtained in the corporation's favor.[18] For example, awards have been sustained in suits by stockholders complaining that shares of their corporation had been issued wrongfully for an inadequate consideration.[19] A successful suit of this type, resulting in cancellation of the shares, does not bring a fund into court or add to the assets of the corporation, but it does benefit the holders of the remaining shares by enhancing their value. Similarly, holders of voting trust certificates have been allowed reimbursement of their expenses from the corporation where they succeeded in terminating the voting trust and obtaining for all certificate holders the right to vote their shares.[20] In these cases there

[18] See, *e. g.*, *Holthusen* v. *Edward G. Budd Mfg. Co.*, 55 F. Supp. 945 (D. C. E. D. Pa. 1944); *Runswick* v. *Floor*, 208 P. 2d 948 (Utah 1949); cases cited n. 22, *infra*. See generally Hornstein, Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards, 69 Harv. L. Rev. 658, 669–679 (1956); Smith, Recovery of Plaintiff's Attorney's Fees in Corporate Litigation, 40 L. A. Bar Bull. 15 (1964).

[19] *Hartman* v. *Oatman Gold Mining & Milling Co.*, 22 Ariz. 476, 198 P. 717 (1921); *Greenough* v. *Coeur D' Alenes Lead Co.*, 52 Idaho 599, 18 P. 2d 288 (1932); cf. *Riverside Oil & Refining Co.* v. *Lynch*, 114 Okla. 198, 243 Pac. 967 (1925).

[20] *Allen* v. *Chase Nat'l Bank*, 180 Misc. 259, 40 N. Y. S. 2d 245 (Sup. Ct. 1943), sequel to *Palley* v. *Chase Nat'l Bank*, 178 Misc. 536, 35 N. Y. S. 2d 958 (Sup. Ct. 1942).

was a "common fund" only in the sense that the court's jurisdiction over the corporation as nominal defendant made it possible to assess fees against all of the shareholders through an award against the corporation.[21]

In many of these instances the benefit conferred is capable of expression in monetary terms, if only by estimating the increase in market value of the shares attributable to the successful litigation. However, an increasing number of lower courts have acknowledged that a corporation may receive a "substantial benefit" from a derivative suit, justifying an award of counsel fees, regardless of whether the benefit is pecuniary in nature.[22] A leading case is *Bosch* v. *Meeker Cooperative Light & Power Association*, 101 N. W. 2d 423 (Minn. 1960), in which a stockholder was reimbursed for his expenses in obtaining a judicial declaration that the elec-

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[21] Cf. Comment, Allowance of Counsel Fees Out of a "Fund in Court": The New Jersey Experience, 17 Rutgers L. Rev. 634, 638–643 (1963).

[22] See *Schechtman* v. *Wolfson*, 244 F. 2d 537, 540 (C. A. 2d Cir., 1957); *Grant* v. *Hartman Ranch Co.*, 193 Cal. App. 2d 497 (1961); *Treves* v. *Servel, Inc.*, 154 A. 2d 188 (Del. Sup. Ct. 1959); *Saks* v. *Gamble*, 154 A. 2d 767 (Del. Ch. 1958); *Yap* v. *Wah Yen Ki Tuk Tsen Nin Hue*, 43 Hawaii 37, 42 (1958); *Berger* v. *Amana Society*, 111 N. W. 2d 753, 758 (Iowa 1962); *Bosch* v. *Meeker Cooperative Light & Power Assn.*, 101 N. W. 2d 423 (Minn. 1960); *Eisenberg* v. *Central Zone Property Corp.*, 1 App. Div. 2d 553, 149 N. Y. S. 2d 840 (Sup. Ct. 1956), aff'd *per curiam*, 3 N. Y. 2d 729, 143 N. E. 2d 516 (1957); *Martin Foundation* v. *Phillip-Jones Corp.*, 283 App. Div. 729, 127 N. Y. S. 2d 649 (Sup. Ct. 1954); *Abrams* v. *Textile Realty Corp.*, 197 Misc. 24, 97 N. Y. S. 2d 494 (Sup. Ct. 1949); *Long Park, Inc.* v. *Trenton-New Brunswick Theatres Co.*, 274 App. Div. 988, 84 N. Y. S. 2d 487 (Sup. Ct. 1948), aff'd *per curiam*, 299 N. Y. 718, 87 N. E. 2d 126 (1949); Smith, *supra*, n. 18; Comment, Shareholder Suits: Pecuniary Benefit Unnecessary for Counsel Fee Award, 13 Stan. L. Rev. 146 (1960).

tion of certain of the corporation's directors was invalid. The Supreme Court of Minnesota stated:

> "Where an action by a stockholder results in a substantial benefit to a corporation he should receive his costs and expenses. . . . [A] substantial benefit must be something more than technical in its consequence and be one that accomplishes a result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder's interest." *Id.*, at 425, 427.

In many suits under § 14 (a), particularly where the violation does not relate to the terms of the transaction for which proxies are solicited, it may be impossible to assign monetary value to the benefit. Nevertheless, the stress placed by Congress on the importance of fair and informed corporate suffrage leads to the conclusion that, in vindicating the statutory policy, petitioners have rendered a substantial service to the corporation and its shareholders. Cf. *Bakery Workers Union* v. *Ratner*, 335 F. 2d 691, 696 (C. A. D. C. Cir. 1964). Whether petitioners are successful in showing a need for significant relief may be a factor in determining whether a further award should later be made. But regardless of the relief granted, private stockholders' actions of this sort "involve corporate therapeutics," [23] and furnish a benefit to all shareholders by providing an important means of enforcement of the proxy statute.[24] To award attorneys' fees in such a suit to a plaintiff who has succeeded in establishing a cause of action is not to saddle the unsuccessful party with the expenses but to impose them on

[23] *Murphy* v. *North Am. Light & Power Co.*, 33 F. Supp. 567, 570 (D. C. S. D N. Y. 1940).

[24] Cf. Hornstein, *supra*, n. 18, at 659, 662–663.

the class that has benefited from them and that would have had to pay them had it brought the suit.

For the foregoing reasons we conclude that the judgment of the Court of Appeals should be vacated and the case remanded to that court for further proceedings consistent with this opinion.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 64.—October Term, 1969

Elmer E. Mills and Louis Susman, Petitioners,
v.
The Electric Auto-Lite Company et al.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[January 20, 1970]

Mr. Justice Black, concurring in part and dissenting in part.

I substantially agree with Parts II and III of the Court's opinion holding that these stockholders have sufficiently proven a violation of § 14 (a) of the Securities and Exchange Act of 1934 and are thus entitled to recover whatever damages they have suffered as a result of the misleading corporate statements, or perhaps to an equitable setting aside of the merger itself. I do not agree, however, to what appears to be the holding in Part IV that stockholders who hire lawyers to prosecute their claims in such a case can recover attorneys' fees in the absence of a valid contractual agreement so providing or an explicit statute creating such a right of recovery. The courts are interpreters, not creators, of legal rights to recover and if there is a need for recovery of attorneys' fees to effectuate the policies of the Act here involved, that need should in my judgment be met by Congress, not by this Court.